In This Issue

Mission of the Service and Statement of Principles of Internal Revenue Tax Administration ii

Introduction iii

Definition of Terms and Abbreviations iv

Numerical Finding List v

Finding List of Current Action on Previously Published Rulings vi

Tax Court 1

Part I.—Rulings and Decisions Under the Internal Revenue Code of 1986 3

Part II.—Treaties and Tax Legislation
Table of Contents 195
Subpart A.—Tax Conventions 196
Subpart B.—Legislation and Related Committee Reports 204

Part III.—Administrative, Procedural and Miscellaneous 293

Notice of Proposed Rulemaking 557
Disbarments and Suspensions List 683
Index 685

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Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

These principles of tax administration were previously published in the Internal Revenue Bulletin as Revenue Procedure 64-22, 1964-1 (Part I) C.B. 689. They are restated here to emphasize their importance to all employees of the Internal Revenue Service.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

Cumulative Bulletin 1990-1 is a consolidation of all items of permanent nature published in the weekly Bulletins 1990-1 through 1990-26 for the period of January 1 through June 30, 1990.

The Internal Revenue Cumulative Bulletin is prepared in three parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986. Arrangement is sequential according to Code and regulations sections. The code section is shown at the top of each page.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Notice of Proposed Rulemaking
The preambles and text of proposed regulations that were published in the **Federal Register** during this six-month period are printed in this section. Included in this section is a list of persons disbarred or suspended from practice before the Internal Revenue Service.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contribution Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List

Court Decisions:

2047, *142*

Delegation Orders:

4 (Rev. 20), *294*
143 (Rev. 4), *295*
222 (Rev. 2), *296*

Notices:

90-1, *297*
90-2, *301*
90-3, *303*
90-4, *303*
90-5, *303*
90-6, *304*
90-7, *304*
90-8, *305*
90-9, *312*
90-10, *319*
90-11, *319*
90-12, *321*
90-13, *321*
90-14, *322*
90-15, *326*
90-16, *326*
90-17, *327*
90-18, *327*
90-19, *328*
90-20, *328*
90-21, *332*
90-22, *334*
90-23, *335*
90-24, *335*
90-25, *336*
90-26, *336*
90-27, *336*
90-28, *339*
90-29, *340*
90-30, *340*
90-31, *341*
90-32, *341*
90-33, *341*
90-34, *341*
90-35, *342*
90-36, *342*
90-37, *343*
90-38, *345*
90-39, *349*
90-40, *350*
90-41, *350*
90-42, *356*

Proposed Regulations:

CO-78-87, *558*
CO-10-89, *559*
CO-008-90, *559*
EE-129-86, *560*
EE-44-87, *561*
EE-61-88, *573*
EE-8-89, *616*
EE-22-90, *617*
FI-105-88, *630*
FI-64-89, *631*
FI-75-89, *631*
FI-76-89, *632*
GL-705-88, *632*
IA-237-84, *633*
IA-130-87, *645*
IA-12-89, *654*
IA-29-89, *663*
IA-012-90, *678*
INTL-40-89, *679*
INTL-0660-89, *680*

Proposed Regulations—Continued

INTL-704-87, *678*
PS-53-89, *681*
PS-065-89, *681*

Public Laws:

101-73, *204*
101-140, *207*
101-194, *209*
101-239, *210*

Railroad Retirement Quarterly Rates:

178

Revenue Procedures:

90-1, *356*
90-2, *386*
90-3, *402*
90-3A, *409*
90-4, *410*
90-5, *421*
90-6, *430*
90-7, *432*
90-8, *434*
90-9, *460*
90-10, *467*
90-11, *469*
90-12, *471*
90-13, *473*
90-14, *473*
90-15, *476*
90-16, *477*
90-17, *479*
90-18, *491*
90-19, *495*
90-20, *495*
90-21, *499*
90-22, *504*
90-23, *507*
90-24, *510*
90-25, *511*
90-26, *512*
90-27, *514*
90-28, *518*
90-29, *533*
90-30, *534*
90-31, *539*
90-32, *546*
90-33, *551*
90-34, *552*
90-35, *555*

Revenue Rulings:

90-1, *155*
90-2, *169*
90-3, *174*
90-4, *13*
90-5, *189*
90-6, *111*
90-7, *153*
90-8, *173*
90-9, *46*
90-10, *42*
90-11, *10*
90-12, *156*
90-13, *65*
90-14, *112*
90-15, *93*
90-16, *12*
90-17, *119*
90-18, *193*
90-19, *186*
90-20, *117*

Revenue Rulings—Continued

90-21, *172*
90-22, *158*
90-23, *28*
90-24, *97*
90-25, *10*
90-26, *124*
90-27, *50*
90-28, *159*
90-29, *11*
90-30, *113*
90-31, *147*
90-32, *177*
90-33, *114*
90-34, *154*
90-35, *48*
90-36, *59*
90-37, *141*
90-38, *57*
90-39, *115*
90-40, *52*
90-41, *161*
90-42, *117*
90-43, *13*
90-44, *54*
90-45, *175*
90-46, *107*
90-47, *187*
90-48, *162*
90-49, *171*
90-50, *116*
90-51, *22*

Social Security Contribution & Benefit Base:

556

Tax Conventions:

Mexico, *196*
Puerto Rico, *199*

Treasury Decisions:

8276, *14*
8277, *96*
8278, *121*
8279, *151*
8280, *80*
8281, *37*
8282, *62*
8283, *148*
8284, *24*
8285, *26*
8286, *138*
8287, *130*
8288, *163*
8289, *106*
8290, *109*
8291, *3*
8292, *180*
8293, *123*
8294, *66*
8295, *165*
8296, *179*
8297, *190*
8298, *64*
8299, *185*
8300, *31*
8301, *99*
8302, *6*

Finding List of Current Action on Previously Published Rulings

Delegation Orders:

4 (Rev. 19)
Superseded by
4 (Rev. 20), *294*

143 (Rev. 3)
Superseded by
143 (Rev. 4), *295*

222 (Rev. 1)
Superseded by
222 (Rev. 2), *296*

Notices:

87-23
Modified by
Rev. Proc. 90-15, *326*

89-22
Supplemented & Modified by
90-1, *297*

Revenue Procedures:

63-7
Modified by
90-26, *512*

73-39
Revoked by
90-27, *514*

75-54
Modified by
90-26, *512*

76-35
Modified by
90-26, *512*

80-26
Superseded by
90-5, *421*

80-30
Modified & Amplified by
90-17, *479*
Modified by
90-20, *495*

83-36
Superseded by
90-4, *410*

83-41
Modified by
90-5, *421*

83-71
Superseded by
90-15, *476*

84-46
Modified & Amplified by
90-17, *479*
Superseded by
90-27, *514*

84-86
Modified & Amplified by
90-17, *479*

85-32
Superseded by
90-27, *514*

85-43
Modified by
90-20, *495*

Revenue Procedures—Continued

87-4
Modified & Amplified by
90-17, *479*

87-40
Superseded by
90-5, *421*

87-47
Superseded by
90-9, *460*

87-50
Modified & Amplified by
90-17, *479*

88-42
Superseded by
90-20, *495*

88-58
Superseded by
90-8, *434*

89-1
Superseded by
90-1, *356*

89-2
Superseded by
90-2, *386*

89-4
Superseded by
90-17, *479*

89-6
Superseded by
90-6, *430*

89-7
Superseded by
90-3, *402*

89-9
Modified & Amplified by
90-17, *479*
Modified by
90-21, *499*

89-13
Modified & Amplified by
90-17, *479*
Modified by
90-20, *495*
90-21, *499*

89-19
Superseded by
90-3, *402*

89-20
Amplified by
90-30, *534*

89-21
Amplified by
90-32, *546*

89-22
Superseded by
90-3, *402*

89-26
Superseded by
90-3, *402*

89-32
Obsoleted in part by
90-24, *510*
90-25, *511*

Revenue Procedures—Continued

89-35
Modified by
90-4, *410*
Modified & Amplified by
90-17, *479*

89-36
Superseded by
90-3, *402*

89-39
Superseded by
90-3, *402*

89-54
Superseded by
90-3, *402*

89-59
Modified by
90-24, *510*

89-63
Superseded by
90-3, *402*

89-66
Amplified by
90-34, *552*

89-67
Amplified & Modified by
90-15, *476*

90-1
Modified by
90-13, *473*
Modified & Amplified by
90-17, *479*

90-3
Supplemented & Clarified by
90-3A, *409*
Amplified by
90-33, *551*
Modified by
90-35, *555*

90-4
Modified & Amplified by
90-17, *479*

Revenue Rulings:

190
Distinguished by
90-23, *28*

55-109
Modified by
90-23, *28*

58-421
Modified & Superseded by
90-35, *48*

59-371
Distinguishable by
90-23, *28*

60-161
Obsoleted by
90-2, *169*

67-246
Amplified by
Rev. Proc. 90-12, *471*

Finding List of Current Action on Previously Published Rulings—Continued

Revenue Rulings—Continued

68-289
Clarified by
90-17, *119*

68-633
Revoked by
90-7, *153*

70-539
Revoked by
90-38, *57*

71-388
Modified by
90-31, *147*

73-124
Revoked by
90-24, *97*

74-26
Obsoleted by
90-25, *10*

74-241
Amplified by
90-35, *48*

75-56
Modified by
90-38, *57*

76-311
Obsoleted by
90-2, *169*

76-325
Modified by
90-38, *57*

77-440
Revoked by
90-42, *117*

77-458
Clarified by
90-17, *119*

79-257
Obsoleted by
90-13, *65*

80-171
Obsoleted by
90-51, *22*

80-210
Obsoleted by
90-2, *169*

81-3
Obsoleted by
90-13, *65*

81-20
Clarified by
90-3, *174*

81-154
Distinguished by
90-8, *173*

83-182
Obsoleted by
90-31, *147*

88-71
Modified by
90-4, *13*

Revenue Rulings—Continued

89-123
Amplified by
90-18, *193*

90-4
Modified by
90-43, *13*

Cumulative List of Announcements Relating to Decisions of the Tax Court Published in the Internal Revenue Bulletin from January 1, 1990 thru June 30, 1990

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Davis, Ronald, et ux[1]	7717-87	92	351
Fisher Companies, Inc.[2]	16064-83	84	1319
Frontier Savings Association & Subs.[3]	16209-81) 24559-83)	87	665
Illinois Power Co.[4]	28136-84	87	1417
Laureys, Frank J., Jr., et ux[5]	23490-85	92	101
Matthews, David W., et ux[1]	4254-87	92	351
Neisen, Est. of Leander, Elizabeth Neisen, Personal Rep.[6]	4909-86	89	939
Perkins, James W.[7]	14968-87	92	749
Sierracin Corp.[8]	28569-83	90	341

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Egger, Est. of Luis G., James H. Powell, Executor[9]	39777-86	92	1079
Fisher Companies, Inc.[10]	16064-83	84	1319
Laureys, Frank J., Jr., et ux[11]	23490-85	92	101

[1]Acquiescence relating to whether the court correctly concluded that petitioners should be entitled to rely upon the receipt of a refund by another taxpayer as IRS acceptance of their position.

[2]Acquiescence relating to whether a violation is a "related violation" within the meaning of section 162(g) of the Code where there is no injunction against the taxpayer accompanying the guilty *nolo contendere* plea in the criminal proceeding.

[3]Acquiescence relating to whether any member bank receiving a stock dividend from a Federal Home Loan Bank has an election to receive stock or property within the meaning of section 305(b)(1) of the Code.

[4]Acquiescence in result relating to whether a transfer of nuclear fuel by petitioner to Illinois Power Fuel Co. (IPF) which was cast as a sale-leaseback was in reality a financing arrangement and whether petitioner is entitled to deduct the liability it accrued for "lease" charges in connection with the transfer of the fuel. Acquiescence "in result" means acceptance of the Court but disagreement with some or all the reasons assigned for the decision.

[5]Acquiescence relating to whether petitioner's transactions were entered into primarily for profit.

[6]Acquiescence in result relating to whether a decedent's will contained a formula bequest within the meaning of section 403(e)(3) of the Economic Recovery Tax Act of 1981, which precludes petitioner from qualifying for an unlimited marital deduction under section 2056 of the Code. Acquiescence "in result" means acceptance of the Court but disagreement with some or all of the reasons assigned for the decision.

[7]Acquiescence in result relating to whether a petitioner can pay interest on a determined deficiency which is before the Tax Court for redetermination without either paying at least a portion of the deficiency or consenting to its assessment. Acquiescence "in result" means acceptance of the Court but disagreement with some or all the reasons assigned for the decision.

[8]Acquiescence in the issue relating to whether petitioner was entitled to use the completed contract method of accounting in reporting income from certain multi-unit manufacturing contracts based on the rationale that the products manufactured under such contracts were "unique" items within the meaning of section 1.451-3(b)(1)(ii) of the regulations. Acquiescence in result in the issue relating to whether such contracts should be severed by delivery pursuant to section 1.451-3(e) of the regulations in order to clearly reflect income. Acquiescence "in result" means acceptance of the Court but disagreement with some or all the reasons assigned for the decision.

[9]Nonacquiescence relating to whether, on remand to the Tax Court, the Tax Court should vacate its earlier decision solely in order to enter a new decision that takes into account additional administration expenses and interest accruing on the deficiency that were not claimed when the case was previously before the Tax Court.

[10]Nonacquiescence relating to if a lump sum payment in settlement of a civil suit is for a period during which there was a violation described in section 162(g) of the Code and this period is contained in the period described in the civil suit, is the payment required to be allocated in proportion to the length of time of each to these periods.

[11]Nonacquiescence relating to whether offsetting positions in stock options constitute a guarantee, stop loss agreement, or similar arrangement within the meaning of section 465(b)(4) of the Code.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Subtitle A.—Income Taxes
Chapter 1.—Normal Taxes and Surtaxes
Subchapter A.—Determination of Tax Liability
Part I.—Tax on Individuals

Section 1.—Tax Imposed

26 CFR 1.1-1: Income tax on individuals.

The Service is providing adjusted tax tables for individuals and trusts and estates for taxable years beginning in 1990 to reflect changes in the cost of living. See Rev. Proc. 90-7, page 432.

Part IV.—Credits Against Tax
Subpart A.—Nonrefundable Personal Credits

Section 25.—Interest on Certain Home Mortgages

26 CFR 1.25-T: Credit for interest paid on certain home mortgages.

Rev. Proc. 89-59 is modified with respect to (1) the average area purchase price safe harbor limitation that may be used for an omitted category of residence (new or existing), and (2) the effective date of national average purchase prices and average area purchase price safe harbor limitations. See Rev. Proc. 90-24, page 510.

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26 CFR 1.25-T: Credit for interest paid on certain home mortgages.

Guidance is provided for the use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio described in secton 143(f)(5) of the Code. See Rev. Proc. 90-25, page 511.

Subpart C.—Refundable Credits

Section 32.—Earned Income

26 CFR 1.43-2: Earned income credit for taxable years beginning after December 31, 1978.

The Service is providing inflation adjustments to the earned income credit for taxable years beginning in 1990. See Rev. Proc. 90-7, page 432.

Subpart D.—Business Related Credits

Section 38.—General Business Credit

26 CFR 1.38-1: Investment in certain depreciable property.

An election is provided to U.S. owners of cargo containers to determine what portion is eligible for the investment tax credit. See Rev. Proc. 90-10, page 467.

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26 CFR 1.38-1: Investment in certain depreciable property.

The investment tax credit is not available for cargo containers if the taxpayer cannot document that the containers were used substantially in the direct transportation of property to or from the U.S. during the taxable year. See Rev. Rul. 90-9, page 46.

Section 40.—Alcohol Used as Fuel

26 CFR 1.40-1: Questions and answers relating to the meaning of the term "qualified mixture" in section 40(b)(1).

T.D. 8291

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Alcohol Fuels Credit; Definition of Mixture

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 40 interpreting the term "mixture" as used in that section. Under these final regulations, ethanol used in the production of ethyl tertiary butyl ether (ETBE) may be eligible for the income tax credit allowed under section 40. These final regulations respond to requests from taxpayers and other interested parties that the Internal Revenue Service clarify the definition of the term "mixture" as used in section 40.

EFFECTIVE DATE: These regulations are effective for sales or uses after September 30, 1980, in tax years ending after September 30, 1980.

SUPPLEMENTARY INFORMATION:

Background

On November 25, 1989, the FEDERAL REGISTER published proposed amendments to the Income Tax Regulations (25 CFR Part 1) under section 40 of the Internal Revenue Code of 1986 (54 FR 48639) [PS-47-89, 1989-2 C.B. 839]. The preamble to that notice of proposed rulemaking contains (1) an explanation of the proposed rules, (2) a discussion of the term "mixture" as that term is used in section 40, and (3) a discussion of the considerations that were taken into account in deciding to issue the proposed regulations. A public hearing was held on January 4, 1990. After consideration of public comments regarding the proposed regulations, the proposed regulations are adopted by this Treasury decision.

Explanation of Provisions

Section 40(a) provides for an alcohol fuels credit equal to the sum of the alcohol mixture credit and the alcohol credit. Section 40(b)(1) provides that the alcohol mixture credit is 60 cents for each gallon of alcohol used by the taxpayer in the production of a "qualified" mixture during the taxable year. The term "qualified mixture" means a mixture of alcohol and gasoline or of alcohol and a special fuel which either (i) is sold by the taxpayer producing such mixture to any person for use as a fuel, or (ii) is used as a fuel by the taxpayer producing the mixture. For purposes of section 40 the term "alcohol" does not include alcohol produced from petroleum, natural gas, or coal.

ETBE is a chemical compound produced in a reaction between ethanol (an alcohol that is not produced from petroleum, natural gas, or coal), and isobutylene (a by-product of petroleum refining). ETBE is then blended with gasoline as an octane enhancer. There is no significant loss in the energy content of ethanol when it is used to produce ETBE.

The final regulations provide that a product derived from alcohol and other components is considered to be a mixture of that alcohol and those other components even if the alcohol is chemically transformed in producing the product so that the alcohol is no longer present as a separate chemical in the final product. Thus, the final regulations provide that a product is considered to be a "mixture of alcohol and gasoline or of alcohol and a special fuel" within the meaning of section 40(b)(1)(B) if such product is produced by blending a chemical compound derived from alcohol with gasoline or a special fuel, so long as there is no significant loss of energy content of the alcohol. For example, a blend of gasoline and ETBE, a compound derived in part

from ethanol, is considered for purposes of section 40(b)(1)(B) to be a mixture of gasoline and the ethanol used to produce the ETBE, even though the ethanol is chemically transformed in the production of ETBE and is not present separately in the final mixture.

Public Comments

Statutory construction

Several commentators suggested that ethanol used to produce ETBE does not qualify for the section 40 credit because ETBE is neither an "alcohol" nor a "mixture" within the meaning of section 40. However, as indicated in the preamble to the proposed regulations, the Service has adopted a nontechnical interpretation of the term "mixture." It was clear prior to issuance of the proposed regulations that ethanol blended with other ingredients to produce an octane enhancer for gasoline could qualify for the section 40 credit. See Rev. Rul. 88-64, 1988-2 C.B. 10. Thus, even prior to issuance of the proposed regulations, it would have been clear that ethanol used to produce ETBE would qualify for the credit if no chemical reaction between ethanol and isobutylene occurred in producing ETBE. The Service has concluded that the fact that such a chemical reaction does occur is without legal significance in view of the purpose of the credit, which is to encourage fuel use of alcohol from renewable sources. The Service has concluded that it would be inconsistent with this purpose to interpret the term "mixture" in such a way that eligibility for the credit depended on whether such a reaction occurred.

Accordingly, the Service has interpreted the term "mixture" broadly, so that the presence or absence of a chemical reaction between ethanol and other ingredients does not affect eligibility for the credit. Therefore, ethanol used to produce ETBE may qualify for the section 40 credit even though it is chemically transformed in the reaction in which ETBE is produced.

"Significant energy loss" standard

Under the proposed regulations, the chemical transformation of alcohol is not taken into account in determining whether a mixture has been produced, "provided that there is no significant loss in the energy content of the alcohol." At least one commentator argued that this requirement is without legal authority and is ambiguous. Although this requirement is not based on the statutory language of section 40, it is necessary and appropriate to carry out its purpose. The preamble to the proposed regulations indicates that this requirement is satisfied in the case of ethanol used to produce ETBE. Whether this requirement would also be satisfied in the case of other alcohol-based products is a factual question that is beyond the scope of the regulations.

Effect of tariff laws

Under United States tariff laws, ethyl alcohol imported for fuel use is subject to a duty of 60 cents a gallon. This duty offsets the credit that would be available for foreign alcohol under section 40. ETBE would not be subject to this duty. A number of commentators noted that ETBE produced in a foreign country from ethanol derived from foreign agricultural products would not be subject to this duty and thus could receive the benefit of the section 40 credit without the offsetting duty.

Several of these commentators suggested that Congress's omission to apply this duty to imported ethers such as ETBE confirms that Congress intended that the section 40 credit not apply to ethanol used to produce ETBE. The Service recognizes that this failure may indicate that Congress, in enacting the duty for ethyl alcohol, may not have contemplated that qualifying alcohols would be used to produce ethers such as ETBE. This omission, however, does not indicate that Congress, in enacting the section 40 credit, intended that the credit would not apply to such ethers.

Other commentators, who agree that the section 40 credit should be available to ethanol used in ETBE, asked that the final regulations interpret the tariff laws in such a way as to apply the duty to ETBE. This issue is beyond the scope of these regulations and is within the jurisdiction of the Customs Service rather than the Internal Revenue Service.

Environmental impact statement

Several commentators suggested that the Service was required by the National Environmental Policy Act of 1969 (NEPA), as amended (42 U.S.C. 4321 et seq), to prepare an environmental impact statement (EIS) prior to issuance of these regulations. As additional authority, the commentators cite the "Department of the Treasury Procedures for Preparation and Coordination of Environmental Impact Statements," 39 FR 14796 (May 1, 1974). The Service disagrees.

Department of the Treasury procedures for the issuance of an EIS are presently contained in Treasury Directive (TD) 75-02. TD 75-02 originated as "Draft Procedures for Implementation of the NEPA Regulations," published for public comment in the Federal Register on July 6, 1979 (44 FR 39692). No public comments were received in response to the publication of the draft procedures. Therefore, "Final Procedures for Implementation of the NEPA Regulations" subsequently were published in the Federal Register on January 8, 1980 (45 FR 1828). As required by regulations promulgated by the Council on Environmental Quality (CEQ), the final procedures were reviewed and approved by CEQ prior to publication.

The 1979 draft procedures and the 1980 final procedures expressly canceled the 1974 procedures, to which the commentators have referred, and provided a "categorical exclusion" from the preparation of an EIS for Service regulations "interpreting, implementing, or clarifying" Internal Revenue Code provisions. An identical exclusion is contained in TD 75-02. Given this categorical exclusion for regulations interpreting, implementing, or clarifying Internal Revenue Code provisions, the Service concludes that no EIS is required in this case.

Effect on the methanol industry

Several commentators suggested that the regulations as proposed will provide an advantage for ethanol used to make ETBE that is not available for methanol used to make methyl tertiary butyl ether (MTBE), a competing octane enhancer with properties similar to ETBE. However, as indicated in the preamble to the proposed regulation, this difference is a logical consequence of the decision made by Congress in 1980 to favor alcohols derived from renewable sources (such as ethanol made from

corn) over alcohol derived from nonrenewable sources (such as methanol made from natural gas).

Revenue loss

Several commentators argued that the proposed regulations should not be adopted because they will result in a significant revenue loss. The primary responsibility of the Service in interpreting statutory provisions is to carry out Congressional intent. The Service believes that these regulations fulfill its responsibility.

Value of credit

At least one commentator argued that, because an ETBE-gasoline blend is a more valuable product than gasohol (and other similar ethanol-gasoline blends), the proposed regulations will result in an effective per gallon subsidy for ethanol used to produce ETBE that exceeds the per gallon subsidy intended by Congress. The value of the section 40 credit can be expected to fluctuate over time as a result of fluctuations in prices of alcohol and gasoline, and of technological changes. The Service does not believe that it is appropriate to take into account the value of the credit for ethanol used as fuel in a particular way (such as ETBE) in determining whether that use qualifies for the credit.

Other effects of regulations

The preamble to the proposed regulations noted that several government agencies had written to Treasury to point out the beneficial effects of ETBE use from a public policy standpoint, and went on to list these effects. A number of commentators argued that it was improper for the decision to issue the regulations to be based on such public policy considerations. These commentators also argued that the effects cited in the preamble would not in fact occur. The Service believes that the proposed regulations are justifiable solely on the grounds of statutory interpretation described in the preamble, taking into account the original purpose of the credit, which was to provide a tax benefit for the fuel use of alcohol derived from renewable sources. Based on the representations of other Executive Branch agencies with relevant expertise, which were referred to in the preamble, however, the Service continues to believe that use of ETBE will have beneficial effects from a standpoint of public policy.

Person eligible for the credit

The preamble to the proposed regulations states that under Rev. Rul. 88-64, 1988-2 C.B. 10, a taxpayer that produces ETBE but does not blend it into gasoline would not be eligible for the section 40 credit. However, a person buying ETBE and blending it with gasoline would be eligible for the credit. Several commentators suggested that the producer of ETBE should be eligible for the credit regardless of whether such producer blends the ETBE with gasoline.

This suggestion is not adopted in the final regulations. The final regulations do not address the issue of whether the producer of ETBE or the blender is eligible for the credit. Under section 40(b)(1)(A), a person is eligible for the alcohol mixture credit if such person produces a "qualified mixture." Under section 40(b)(1)(B), a qualified mixture includes a mixture of alcohol and gasoline or of alcohol and a special fuel which is sold by the taxpayer producing such mixture for use as a fuel. The Service's position is that ETBE is not sold "for use as a fuel," but rather is sold for use as a fuel additive. Therefore, the Service believes that a taxpayer that produces ETBE but does not blend it into gasoline would not be eligible for the section 40 credit. However, a person buying ETBE and blending it with gasoline would be eligible for the credit. This position is based on Rev. Rul. 88-64 and the authorities cited therein, and not on the final regulations.

Regulatory Impact Analysis

Several commentators argued that the proposed regulations are "major regulations" as defined in Executive Order 12291, and that a Regulatory Impact Analysis is therefore required. The Treasury Department has determined, after consultation with the Office of Management and Budget, that the impact of the proposed regulations is not sufficiently great to require performance of a Regulatory Impact Analysis under Executive Order 12291.

Special Analyses

As noted in the preceding paragraph, it has been determined that these regulations are not major regulations as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, a copy of these regulations has been submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 C.F.R. Part 1 is amended as follows:

PART 1—INCOME TAX

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805 ***

Par. 2. Section 1.40-1 is revised to read as follows:

§1.40-1 Questions and answers relating to the meaning of the term "qualified mixture" in section 40(b)(1).

Q-1. What is a "qualified mixture" within the meaning of section 40(b)(1)?

A-1. A "qualified mixture" is a mixture of alcohol and gasoline or of alcohol and a special fuel which (1) is sold by the taxpayer producing such mixture to any person for use as a fuel, or (2) is used as a fuel by the taxpayer producing such mixture.

Q-2. Must alcohol be present in a product in order for that product to be considered a mixture of alcohol and either gasoline or a special fuel?

A-2. No. A product is considered to be a mixture of alcohol and gasoline or of alcohol and a special fuel if the product is derived from alcohol and either gasoline or a special fuel even if the alcohol is chemically transformed in producing the product so that the alcohol is no longer present as a separate chemical in the final product, provided that there is

no significant loss in the energy content of the alcohol. Thus, a product may be considered to be a "mixture of alcohol and gasoline or of alcohol and a special fuel" within the meaning of section 40(b)(1)(B) if such product is produced in a chemical reaction between alcohol and either gasoline or a special fuel. Similarly a product may be considered to be a "mixture of alcohol and gasoline or of alcohol and a special fuel" if such product is produced by blending a chemical compound derived from alcohol with either gasoline or a special fuel.

Thus, for example, a blend of gasoline and ethyl tertiary butyl ether (ETBE), a compound derived from ethanol (a qualified alcohol), in a chemical reaction in which there is no significant loss in the energy content of the ethanol, is considered for purposes of section 40(b)(1)(B) to be a mixture of gasoline and the ethanol used to produce the ETBE, even though the ethanol is chemically transformed in the production of ETBE and is not present in the final product.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved February 23, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 6, 1990, 8:45 a.m., and published in the issue of the Federal Register for March 9, 1990, 55 F.R. 8946)

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1990. See Rev. Rul. 90-1, page 155.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1990. See Rev. Rul. 90-12, page 156.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1990. See Rev. Rul. 90-22, page 158.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 1990. See Rev. Rul. 90-28, page 159.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1990. See Rev. Rul. 90-41, page 161.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 1990. See Rev. Rul. 90-48, page 162.

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26 CFR 1.42-0: Table of contents.

T.D. 8302

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Low-income Housing Credit for Federally-assisted Buildings

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning the low-income housing credit for certain Federally-assisted buildings under section 42 of the Internal Revenue Code of 1986, as enacted by section 252 of the Tax Reform Act of 1986 and, as amended by sections 1002(1) and 4003 of the Technical and Miscellaneous Revenue Act of 1988. The changes to section 42 under section 7108 of the Omnibus Reconciliation Act of 1989 are not reflected in these final regulations but will be the subject of a separate notice of proposed rulemaking. The regulations provide guidance concerning the low-income housing credit allowable for certain Federally-assisted buildings acquired during a 10-year period.

EFFECTIVE DATE: The regulations are effective January 1, 1987.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this final regulation has been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545-1005. The estimated average burden associated with the collection of information in this final rule is 3 hours per respondent or recordkeeper. These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents or recordkeepers may require greater or less time, depending upon their particular circumstances.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer T:FP, Washington, D.C. 20224.

Background

On November 3, 1987, the FEDERAL REGISTER published a notice of proposed rulemaking (52 FR 42116) [LR-62-87, 1987-2 C.B. 1055] by cross reference to temporary regulations published the same day (52 FR 42098) [T.D. 8162, 1987-2 C.B. 24] under section 42 of the Internal Revenue Code of 1986. A number of public comments were received concerning these regulations, and a public hearing was held on March 17, 1988. After consideration of the written comments and those presented at the hearing, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions

Section 252 of the Tax Reform Act of 1986 (100 Stat. 2189) [Pub. L. 99-514, 1986-3 C.B. (Vol. 1) 1, 106] as amended by sections 1002(1) and 4003 of the Technical and Miscellaneous Act of 1988 (102 Stat. 3373, 3643) [Pub. L. 100-647, 1988-3 C.B. 1, 33, 303] enacted a new low-income housing credit under section 42 of the Internal Revenue Code of 1986. The credit is equal to the applicable percentage of the qualified basis of each qualified low-income building. The temporary regulations published in

the FEDERAL REGISTER on November 3, 1987, provide guidance with respect to the credit allowable for certain Federally-assisted buildings acquired during a 10-year period. The low-income housing credit is available to the acquirer of a qualified low-income building for which a special waiver is granted by the Internal Revenue Service in order to avert an assignment of the mortgage secured by the building to the Department of Housing and Urban Development or the Farmers' Home Administration, or to avert a claim against a Federal mortgage insurance fund with respect to a mortgage which is so secured.

Public Comment

Several commentators suggested that the waiver under section 42(d)(6) should apply to a project, as well as a building. In response to this comment, proposed §1.42-2(d)(3) has been revised to indicate that a single waiver application can be filed for a project consisting of multiple buildings as long as the information required for each building is identified by building address. Proposed §1.42-2(d)(3) has also been revised to indicate that a waiver application can be filed for specific buildings that are Federally-assisted in a project consisting of multiple buildings that may or may not be Federally-assisted.

Several commentators requested that the certification that Federal mortgage funds are at risk should come from the Federal agency, rather than the taxpayer. This suggestion has been adopted, and proposed §1.42-2(c)(3) has been revised to indicate that the Federal agency is to provide such certification in the form of a letter or other written statement made or received and approved by the national office of the Federal agency.

Several commentators contended that it is unclear what documentation taxpayers must provide to evidence the specified Federal agency action that must have been taken to demonstrate that a waiver is necessary to avert Federal mortgage funds being at risk. In response to this, proposed §1.42-2(c)(3) has been revised to indicate that a latter or other written statement made or received and approved by the national office of the Federal agency is sufficient specified Federal agency action.

Several commentators urged that a building should qualify as troubled if it shows a history of financial distress, whether or not the owner has defaulted on a mortgage payment. In response, the proposed rule has been revised to indicate that designation of troubled status must be based on a review by the Federal agency of the financial condition of the building or project and on a determination by the agency of a history of financial distress or mortgage defaults. See §1.42-2(c)(3)(ii)(D).

A commentator urged that the granting of a waiver under section 42(d)(6)(A) should be contingent on approval by the Federal agency of the past performance of the current owner/seller of the building or project. Because the Federal agency already has the ability to take this factor into account under proposed §1.42-2(c)(3) (relating to action by the Department of Housing and Urban Development or the Farmers' Home Administration), this comment is not specifically incorporated in the final regulations.

A commentator requested that the waiver under section 42(d)(6) should be available where a change in ownership is being forced due to conditions beyond the control of the owner of the building or project, such as death or bankruptcy. Under section 42(d)(6)(A) and proposed §1.42-2(c)(3) the Federal agency already has sufficient latitude to consider circumstances such as death or bankruptcy. Therefore, the final regulations do not specifically adopt this recommendation.

A commentator stated that proposed §1.42-2(a) should explicitly reference section 42(d)(2)(A)(i)(II) which permits the inclusion in eligible basis of amounts chargeable to capital account and incurred by the taxpayer (before the close of the 1st taxable year of the credit period for such building) for property (or additions or improvements to property) of a character subject to the allowance for depreciation. In response to this comment, proposed §1.42-2(a) has been revised to contain a reference to determining eligible basis under section 42(d)(2).

A commentator recommended adding language to proposed §1.42-2(c)(4) (relating to the waiver requirement that no prior owner was allowed a low-income housing credit for the building) to cover situations where the building or project is acquired after the end of the 15-year compliance period in section 42(i)(1). This recommendation has not been adopted since section 42(n) provides that the State housing credit ceiling is zero for any calendar year after 1989.

A commentator requested that since the existence of a mortgage is a prerequisite to a waiver application, proposed §1.42-2(d)(2)(ix) should change the phrase "any outstanding mortgage" to "the outstanding mortgage" and delete the phrase "if any,". The proposed rule has been clarified in response to this request. See §1.42-2(d)(2)(vii).

A commentator requested clarification concerning the effective date of a waiver. In response to this, proposed §1.42-2(d)(4) has been clarified to state that the waiver is effective when granted by the Internal Revenue Service. Previously, it was stated that a waiver will be effective when granted but in no event later than 60 days after a taxpayer files a substantially complete application for waiver. Some taxpayers believed this language granted an automatic waiver, if a waiver was not granted within 60 days. The intent behind the 60 day period was that if a waiver was granted after the expiration of 60 days from the date the application was filed, the waiver would be effective starting 60 days after the filing date. Given this confusion, the 60 day language has been deleted from the proposed §1.42-2(d)(4).

Several commentators urged that non-Federally-assisted buildings or projects should be eligible for the waiver of the 10-year rule under section 42(d)(6). This suggestion has not been adopted because only a Federally-assisted building, as defined in section 42(d)(6)(B), is eligible to apply for the waiver.

Several commentators contended that buildings or projects that have already been foreclosed upon by the Department of Housing and Urban Development or the Farmers' Home Administration should be eligible for the waiver of the 10-year rule under section 42(d)(6). This suggestion has not been adopted as it is inconsistent

with the section 42(d)(6)(A) requirement that a waiver be necessary "to avert an assignment of the mortgage" or "to avert a claim against a Federal mortgage insurance fund. . .".

Several commentators stated that the regulations should address "other circumstances of financial distress" contained in section 42(d)(6)(A)(iii) with respect to eligibility for waiver of the 10-year rule contained in section 42(d)(2)(B)(ii). Section 42(d)(6)-(A)(iii) was eliminated by the Technical and Miscellaneous Revenue Act of 1988.

The Internal Revenue Service also invited public comments on any other issues arising under section 42 with respect to which guidance is needed. A number of comments were received, and, while those comments are not discussed in this Treasury decision, they will be taken into account in promulgating other regulations under section 42. The Internal Revenue Service appreciates the submission of those comments.

Special Analyses

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis therefore is not required.

Although a notice of proposed rulemaking that solicited public comment was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public procedure requirements of 5 U.S.C. 553 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

* * * * *

Adoption of Amendments to the Regulations

The amendments to 26 CFR Parts 1 and 602 are as follows: PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1986.

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. *** Section 1.42-2 also issued under 26 U.S.C. 42(m).

Par. 2. New §§1.42-0 and 1.42-2 are added in the appropriate place and §1.42-1 is removed and reserved. The added provisions read as follows:

§1.42-0 Table of contents.

This section lists the paragraphs contained in §§1.42-1 and 1.42-2.

§1.42-1 [Reserved]

§1.42-2 Waiver of requirement that an existing building eligible for the low-income housing credit was last placed in service more than 10 years prior to acquisition by the taxpayer.

(a) Low-income housing credit for existing building

(b) Waiver of 10-year holding period requirement

(c) Waiver requirements

(1) Federally-assisted building

(2) Federal mortgage funds at risk

(3) Statement by the Department of Housing and Urban Development or the Farmers' Home Administration

(4) No prior credit allowed

(d) Application for waiver

(1) Time and manner

(2) Information required

(3) Other rules

(4) Effective date of waiver

(5) Attachment to return

(e) Effective date of regulations

§1.42-1 [Reserved]

§1.42-2 Waiver of requirement that an existing building eligible for the low-income housing credit was last placed in service more than 10 years prior to acquisition by the taxpayer.

(a) *Low-income housing credit for existing building.* Section 42 provides that, for purposes of section 38, new and existing qualified low-income buildings are eligible for a low-income housing credit. The eligibility rules for new and existing buildings differ. Under section 42(d)(2), an existing building may be eligible for the low-income housing credit based upon the acquisition cost and amounts chargeable to capital account (to the extent properly included in eligible basis) if—

(1) The taxpayer acquires the building by purchase (as defined in section 179(d)(2), as applicable under section 42(d)(2)(D)(iii)(I)),

(2) There is a period of at least 10 years between the date of the building's acquisition by the taxpayer and the later of—

(i) The date the building was last placed in service, or

(ii) The date of the most recent nonqualified substantial improvement of the building, and

(3) The building was not previously placed in service by the taxpayer, or by a person who was a related person (as defined in section 42(d)(2)(D)-(iii)(II)) with respect to the taxpayer as of the time the building was last previously placed in service.

(b) *Waiver of 10-year holding period requirement.* Section 42(d)(6) provides that a taxpayer may apply for a waiver of the 10-year holding period requirement specified in paragraph (a)(2) of this section. The Internal Revenue Service will grant a waiver only if—

(1) The existing building satisfies all of the requirements in paragraph (c) of this section, and

(2) The taxpayer makes an application in conformity with the requirements in paragraph (d) of this section.

(c) *Waiver requirements*—(1) *Federally-assisted building.* To satisfy the requirement of this paragraph, a building must be a Federally-assisted building The term "Federally-assisted building" means any building which is substantially assisted, financed, or operated under section 8 of the United States Housing Act of 1937, section 221(d)(3) or 236 of the National Housing Act, or section 515 of the Housing Act of 1949, as such acts were in effect on October 22, 1986.

(2) *Federal mortgage funds at risk.* To satisfy the requirement of this paragraph, Federal mortgage funds must be at risk with respect to a mortgage that is secured by the building or a project of which the building is a part. For purposes of this paragraph, Federal mortgage funds are at risk if, in the event of a default by the mortgagor on the mortgage secured by the building or the project of which the building is a part—

(i) The mortgage could be assigned to the Department of Housing and Urban Development or the Farmers' Home Administration, or

(ii) There could arise a claim against a Federal mortgage insurance fund (or such Department or Administration).

(3) *Statement by the Department of Housing and Urban Development or the Farmers' Home Administra-*

tion. (i) to satisfy the requirement of this paragraph, a letter or other written statement must be made or received and approved by the national office of the Department of Housing and Urban Development or the Farmers' Home Administration ("the Federal agency"). This letter or statement shall include the following:

(A) A statement that, as of the earlier of the time of the taxpayer's acquisition of the building or the taxpayer's application for a waiver, the building is a Federally-assisted building within the meaning of paragraph (c)(1) of this section and identifies the source of Federal assistance;

(B) A statement that a waiver of the 10-year holding period requirement is necessary to avert Federal mortgage funds being at risk within the meaning of paragraph (c)(2) of this section; and

(C) A statement that the Federal agency has taken a Federal agency action as described in paragraph (c)(3)(ii) of this section.

(ii) The following specified Federal agency actions shall be the only means of satisfying the requirement of this paragraph:

(A) The Federal agency intends to accept an assignment of a mortgage secured by the building or the project of which the building is a part, and such assignment requires payments by the agency or a mortgage insurance fund maintained by the agency to the prior mortgagee;

(B) The Federal agency or a mortgage insurance fund maintained by the agency intends to accept, as a consequence of foreclosure proceedings or otherwise, conveyance of the building or the project of which the building is a part;

(C) The Federal agency or a mortgage insurance fund maintained by the agency intends, as a consequence of default, to take possession of, hold title to, or otherwise assume ownership of the building or the project of which the building is a part; or

(D) The Federal agency has designated the building or the project of which the building is a part as a troubled building or project. A designation of a troubled building or project must satisfy the following requirements:

(*1*) Designation of troubled status must be based on a review by the Federal agency of the financial condition of the building or project and on a determination by the Federal agency of a history of financial distress or mortgage defaults;

(*2*) Designation of troubled status must be made or received and approved by the national office of the Federal agency; and

(*3*) Federal agency regulations or procedures must provide that, in the event of transfer of the ownership of a designated troubled building or project, the building or project may be subject to continued review by the Federal agency. Each Federal agency may prescribe its own standards and procedures for designating a troubled building or project so long as such standards are consistent with the requirements of this paragraph (c)(3)(ii)(D).

(4) *No prior credit allowed.* The requirement of this paragraph is satisfied only if no prior owner was allowed a low-income housing credit under section 42 for the building.

(d) *Application for waiver*—(1) *Time and manner.* In order to receive a waiver of the 10-year holding period requirement specified in paragraph (a)(2) of this section, a taxpayer must file an application (including the applicable user fee) that complies with the requirements of this paragraph (d) and Rev. Proc. 90-1, page 356, this Bulletin (or any subsequent applicable revenue procedure). The application must be filed by a taxpayer who has acquired the building by purchase or who has a binding contract to purchase the building. Such binding contract may be conditioned upon the granting of a waiver under this section. The application may be filed at any time after a binding contract has been entered into, but no later than 12 months after the taxpayer's acquisition of the building. An application for a waiver of the 10-year holding period requirement must not contain a request for a ruling on any other issue arising under section 42 or other sections of the Internal Revenue Code. An application for a waiver of the 10-year holding period requirement must be mailed or delivered to the address listed in section 3.01 of Rev. Proc. 90-1 (or any subsequent applicable revenue procedure).

(2) *Information required.* An application for a waiver of the 10-year holding period requirement must contain the following information:

(i) The taxpayer's name, address and taxpayer identification number;

(ii) The name (if any) and address of the acquired building and the project (if any) of which it is a part;

(iii) The date of acquisition or the date of the binding contract for acquisition of the building by the taxpayer and the expected date of acquisition, the amount of consideration paid or to be paid for the acquisition (including the value of any liabilities assumed by the taxpayer), and the taxpayer's certification that such acquisition is by purchase (as defined in section 179(d)(2), as applicable under section 42(d)(2)(D)(iii)(I));

(iv) The identity of the person from whom the building is acquired, and whether such person is a Federal agency, a mortgagee holding title to the building, or the mortgagor or prior owner;

(v) The date the building was last placed in service and the date of the most recent (if any) nonqualified substantial improvement of the building (as defined in section 42(d)(2)(D)(i));

(vi) The taxpayer's certification that the building was not previously placed in service by the taxpayer, or by a person who was a related person (as defined in section 42(d)(2)(D)-(iii)(II)) with respect to the taxpayer as of the time the building was last placed in service;

(vii) The amount and disposition (*e.g.*, discharge, assignment, assumption, or refinance) of the outstanding mortgage at the time of acquisition and the identities of the mortgagee and mortgagor;

(viii) The taxpayer's certification that no prior owner was allowed a low-income housing credit under section 42 for the building (made to the best of the taxpayer's knowledge, with no documentation from other persons needed to be submitted); and

(ix) The statement from the Federal agency required by paragraph (c)(3)(i) of this section.

(3) *Other rules.* (i) In the event that an acquired building will be owned by more than one taxpayer, a single application for waiver may be filed by one taxpayer on behalf of the co-owners if the application contains the names, addresses and taxpayer identification numbers of the other owners. A general partner or a desig-

nated limited partner may file an application for waiver on behalf of a partnership.

(ii) In the event that multiple Federally-assisted buildings in a project are being acquired by the taxpayer, a single application for waiver with respect to such buildings may be filed if the application contains the required information set out for the address of each Federally-assisted building involved.

(iii) In the event that specific Federally-assisted buildings are being acquired by the taxpayer in a project consisting of multiple buildings that may or may not be Federally-assisted, a single application for waiver with respect to the Federally-assisted buildings being acquired may be filed if the application contains the required information set out for the address of each Federally-assisted building being acquired.

(4) *Effective date of waiver.* A waiver will be effective when granted in writing by the Internal Revenue Service after submission of a completed application for waiver filed under this paragraph (d).

(5) *Attachment to return.* A waiver letter granted by the Internal Revenue Service shall be filed with the taxpayer's Federal income tax return for the first taxable year the low-income housing credit is claimed by the taxpayer.

(e) *Effective date of regulations.* The provisions of §1.42-2 are effective for buildings placed in service by the taxpayer after December 31, 1986.

Par. 3. Section 1.42-2T is hereby removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for Part 602 continues to read as follows: Authority: 26 U.S.C. 7805.

Par. 5. Section 602.101(c) is amended by removing the entry for "§1.42-2T" and adding in the appropriate place "§1.42-2. . .1545-1005".

Michael J. Murphy,
Acting Commissioner of Internal Revenue.

Approved February 2, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 22, 1990, 8:45 a.m., and published in the issue of the Federal Register for May 23, 1990, 55 F.R. 21187)

Subpart E.—Rules for Computing Credit for Investment in Certain Depreciable Property

Section 47.—Certain Dispositions, etc., of Section 38 Property

26 CFR 1.47-1: Recomputation of credit allowed by section 38.
(Also Section 1398.)

Obsolete revenue ruling. Rev. Rul. 74-26 relating to transfers (other than by sale or exchange) of section 38 property from an individual debtor to a trustee in a bankruptcy proceeding that was commenced after March 24, 1981, is declared obsolete.

Rev. Rul. 90-25

Section 1398(f)(1) of the Internal Revenue Code, which is applicable to any case under Chapter 7 or Chapter 11 of Title 11 of the United States Code in which the debtor is an individual, provides that a transfer (other than by sale or exchange) of an asset from the debtor to the estate shall not be treated as a disposition for purposes of any provision of the Code assigning tax consequences to a disposition, and that the estate shall be treated as the debtor would be treated with respect to such asset. Section 1398(f)(1) is effective for bankruptcy cases commencing after March 24, 1981. Rev. Rul. 74-26, 1974-1 C.B. 7, holds that a transfer in a bankruptcy proceeding of an individual's section 38 property to a trustee in bankruptcy is a transfer within the meaning of section 1.47-1(c)(1)(ii) of the Income Tax Regulations that results in a recapture determination under section 47. Accordingly, Rev. Rul. 74-26 is obsoleted for transfers (other than by sale or exchange) of section 38 property from an individual debtor to a trustee in a bankruptcy proceeding that was commenced after March 24, 1981, under Chapter 7 or Chapter 11 of Title 11 of the United States Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 74-26 is obsoleted for transfers (other than by sale or exchange) of section 38 property from an individual debtor to a trustee in a bankruptcy proceeding that was commenced after March 24, 1981, under Chapter 7 or Chapter 11 of Title 11 of the United States Code.

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26 CFR 1.47-1: Recomputation of credit allowed by section 38.

An election is provided to U.S. owners of cargo containers to determine what portion is eligible for the investment tax credit. See Rev. Proc. 90-10, page 467.

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26 CFR 1.47-1: Recomputation of credit allowed by section 38.

The investment tax credit is not available for cargo containers if the taxpayer cannot document that the containers were used substantially in the direct transportation of property to or from the U.S. during the taxable year. See Rev. Rul. 90-9, page 46.

Section 48.—Definitions; Special Rules

26 CFR 1.48-1: Definition of section 38 property.

An election is provided to U.S. owners of cargo containers to determine what portion is eligible for the investment tax credit. See Rev. Proc. 90-10, page 467.

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26 CFR 1.48-1: Definition of section 38 property.

The investment tax credit is not available for cargo containers if the taxpayer cannot document that the containers were used substantially in the direct transportation of property to or from the U.S. during the taxable year. See Rev. Rul. 90-9, page 46.

Subchapter B.—Computation of Taxable Income
Part I.—Definition of Gross Income, Adjusted Gross Income, Taxable Income, etc.

Section 61.—Gross Income Defined

(Also Sections 301, 382, 1001; 26 CFR 1.301-1, 1.382-2T, 1.1001-1.)

Adoption of poison pill plans. The adoption of the described "poison pill" plan by the corporation's board of directors does not constitute the distribution of stock or property by the corporation to its shareholders, an exchange of property or stock (either taxable or nontaxable), or any other event giving rise to the realization of gross income by any taxpayer.

Rev. Rul. 90-11

ISSUE

What are the federal income tax consequences, if any, of a corpora-

tion's adoption of a plan as described below, commonly referred to as a "poison pill" plan, which provides the corporation's shareholders with the right to purchase additional shares of stock upon the occurrence of certain events?

FACTS

X is a publicly held domestic corporation. *X*'s board of directors adopted a plan (the "Plan") that provides the common shareholders of *X* with "poison pill" rights (the "Rights"). The adoption of the Plan constituted the distribution of a dividend under state law. The principal purpose of the adoption of the Plan was to establish a mechanism by which the corporation could, in the future, provide shareholders with rights to purchase stock at substantially less than fair market value as a means of responding to unsolicited offers to acquire *X*.

The Rights are rights to purchase a fraction of a share of "preferred stock" for each share of common stock held upon the occurrence of a "triggering event," subject to the restrictions described below. The fractional share of preferred stock has voting, dividend, and liquidation rights that make it the economic equivalent of one common share. Until the issuance of the Rights certificates, as described below, the Rights are not exercisable or separately tradable, nor are they represented by any certificate other than the common stock certificate itself. If no triggering event occurs, the Rights expire *a* years after their creation.

A triggering event is the earlier of the tender offer for, or actual acquisition of, at least *b* percent of *X*'s common stock by an investor or investor group. If *X* does not redeem the Rights, as described below, by the end of the *c*-day period following a triggering event, it must issue Rights certificates to all persons that held *X* common stock on the date of the triggering event, including the investor or investor group that caused the triggering event. Once issued, the Rights certificates are tradable separately from the common stock. At any time until *d* days after the actual acquisition by an investor or investor group of at least *b* percent of *X*'s common stock, *X* can redeem the Rights without shareholder approval (whether or not *X* has at that time issued Rights certificates, as described above) for *e* cents per Right, which is a nominal amount in relation to the current market value of the share of *X* common stock.

Upon the issuance of the Rights certificates, the Rights can be exercised but, until a "flip-in" or "flip-over" event, the exercise price is several times the trading price of a share of common stock at the time *X* adopted the Plan. A flip-in event is either (1) the actual acquisition by an investor or inventor group of *f* percent of *X*'s common stock, or (2) a business combination in which *X* is the surviving corporation. A flip-over event is a business combination in which *X* is not the surviving corporation. The occurrence of a flip-in event gives the holder of each Right other than the investor or investor group the right to buy, for *g* dollars, stock of *X* that has a value substantially greater than *g* dollars. A flip-over event gives the holder of each Right other than the investor or investor group the right to buy, for *g* dollars, stock of the surviving corporation that has a value substantially greater that *g* dollars.

At the time *X*'s board of directors adopted the Plan, the likelihood that the Rights would, at any time, be exercised was both remote and speculative.

HOLDING

The adoption of the Plan by *X*'s board of directors does not constitute the distribution of stock or property by *X* to its shareholders, an exchange of property or stock (either taxable or nontaxable), or any other event giving rise to the realization of gross income by any taxpayer. This revenue ruling does not address the federal income tax consequences of any redemption of Rights, or of any transaction involving Rights subsequent to a triggering event.

The temporary Income Tax Regulations under section 1.382-2T(h)(4)(x) grant the Service authority to exempt certain categories of interests from the operation of the option attribution rules of section 1.382-2T(h)(4)(i). Pursuant to these regulations, rights similar to those provided for by the Plan are excepted from the operation of section 1.382-2T(h)(4)(i) until the rights can no longer be redeemed for a nominal amount by the issuing corporation without shareholder approval. Rights will be considered similar to those provided for by the Plan only if the principal purpose for the adoption of the plan providing for such rights is to establish a mechanism by which a publicly held corporation can, in the future, provide shareholders with rights to purchase stock at substantially less than fair market value as a means of responding to unsolicited offers to acquire the corporation. The exception of rights from the operation of section 1.382-2T(h)(4)(i) will be effective for rights provided for by plans adopted before, on, or after the date of publication of this revenue ruling in the Internal Revenue Bulletin.

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26 CFR 1.61-2: Compensation for services, including fees commissions, and similar items.

Amounts paid by an employer pursuant to a leave-sharing plan. Amounts paid by an employer pursuant to a leave-sharing plan are includible in the gross income of the recipient as compensation for services provided by the recipient to the employer and are wages for employment tax purposes.

Rev. Rul. 90-29

ISSUE

What are the federal income tax consequences to employees under the leave-sharing plan described below?

FACTS

An employer established a plan whereby its employees who suffer "medical emergencies" may qualify as recipients of leave surrendered to the employer by other employees or leave deposited by its employees in an employer-sponsored leave bank. A "medical emergency" is defined under the plan as a medical condition of the employee or a family member of the employee that will require the prolonged absence of the employee from duty and will result in a substantial loss of income to the employee because the employee will have exhausted all paid leave available

apart from the leave-sharing plan. Under the provisions of the plan, a written application describing the medical emergency must be submitted to the employer by or on behalf of the employee requesting additional paid leave under the leave-sharing plan. After the application has been approved and the employee has exhausted all of his or her paid leave, the employee is eligible to receive additional paid leave (to be paid at his or her normal rate of compensation) with respect to leave surrendered to the employer or leave deposited in the leave bank. The plan contains restrictions on the amount of leave that may be surrendered to the employer or deposited in the leave bank and also contains rules as to the manner in which surrendered or deposited leave will be granted to eligible leave recipients.

HOLDING

The amounts paid by the employer to a leave recipient pursuant to the plan are includible in the gross income of the recipient under section 61 of the Code as compensation for services provided by that recipient to the employer. These amounts are considered "wages" for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, the Railroad Retirement Tax Act, the Railroad Unemployment Repayment Tax, and income tax withholding, unless excluded therefrom under a specific provision of the Code. An employee who surrenders leave to the employer or deposits leave in the leave bank does not realize any income and incurs no deductible expense or loss either upon the surrender or deposit of the leave or its use by the recipient. The holding and underlying rationale of this ruling apply only to bona fide employer-sponsored leave-sharing arrangements.

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26 CFR 1.61-12: Income from discharge of indebtedness.
(Also Sections 108, 1001; 1.108(a)-1, 1.1001-2.)

Property transfer by insolvent taxpayer in satisfaction of debt secured by property. A transfer of property to a bank in satisfaction of a debt on which the taxpayer is personally liable and which is secured by the property is a disposition upon which gain is recognized under sections 1001(c) and 61(a)(3) of the Code to the extent the fair market value of the property exceeds the taxpayer's adjusted basis in the property.

Rev. Rul. 90-16

ISSUE

A taxpayer transfers to a creditor a residential subdivision that has a fair market value in excess of the taxpayer's basis in satisfaction of a debt for which the taxpayer was personally liable. Is the transfer a sale or disposition resulting in the realization and recognition of gain by the taxpayer under sections 1001(c) and 61(a)(3) of the Internal Revenue Code?

FACTS

X was the owner and developer of a residential subdivision. To finance the development of the subdivision, *X* obtained a loan from an unrelated bank. *X* was unconditionally liable for repayment of the debt. The debt was secured by a mortgage on the subdivision.

X became insolvent (within the meaning of section 108(d)(3) of the Code) and defaulted on the debt. *X* negotiated an agreement with the bank whereby the subdivision was transferred to the bank and the bank released *X* from all liability for the amounts due on the debt. When the subdivision was transferred pursuant to the agreement, its fair market value was 10,000*x* dollars, *X*'s adjusted basis in the subdivision was 8,000*x* dollars, and the amount due on the debt was 12,000*x* dollars, which did not represent any accrued but unpaid interest. After the transaction *X* was still insolvent.

LAW AND ANALYSIS

Sections 61(a)(3) and 61(a)(12) of the Code provide that, except as otherwise provided, gross income means all income from whatever source derived, including (but not limited to) gains from dealings in property and income from discharge of indebtedness.

Section 108(a)(1)(B) of the Code provides that gross income does not include any amount that would otherwise be includible in gross income by reason of discharge (in whole or in part) of indebtedness of the taxpayer if the discharge occurs when the taxpayer is insolvent. Section 108(a)(3) provides that, in the case of a discharge to which section 108(a)(1)(B) applies, the amount excluded under section 108(a)(1)(B) shall not exceed the amount by which the taxpayer is insolvent (as defined in section 108(d)(3)).

Section 1.61-6(a) of the Income Tax Regulations provides that the specific rules for computing the amount of gain or loss from dealings in property under section 61(a)(3) are contained in section 1001 and the regulations thereunder.

Section 1001(a) of the Code provides that gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain.

Section 1001(b) of the Code provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

Section 1001(c) of the Code provides that, except as otherwise provided in subtitle A, the entire amount of the gain or loss, determined under section 1001, on the sale or exchange of property shall be recognized.

Section 1.1001-2(a)(1) of the regulations provides that, except as provided in section 1.1001-2(a)(2) and (3), the amount realized from a sale or other disposition of property includes the amount of liabilities from which the transferor is discharged as a result of the sale or disposition. Section 1.1001-2(a)(2) provides that the amount realized on a sale or other disposition of property that secures a recourse liability does not include amounts that are (or would be if realized and recognized) income from the discharge of indebtedness under section 61(a)(12). *Example (8)* under section 1.1001-2(c) illustrates these rules as follows:

Example (8). In 1980, F transfers to a creditor an asset with a fair market value of $6,000 and the creditor discharges $7,500 of indebtedness for which F is personally liable. The amount realized on the disposition of the asset is its fair market value ($6,000). In addition, F has income from the discharge of indebtedness of $1,500 ($7,500 − $6,000).

In the present situation, *X* transferred the subdivision to the bank in satisfaction of the 12,000*x* dollar debt. To the extent of the fair market value of the property transferred to the creditor, the transfer of the subdivision is treated as a sale or disposition upon which gain is recognized under section 1001(c) of the Code. To the extent the fair market value of the subdivision, 10,000*x* dollars, exceeds its adjusted basis, 8,000*x* dollars, *X* realizes and recognizes gain on the transfer. *X* thus recognizes 2,000*x* dollars of gain.

To the extent the amount of debt, 12,000*x* dollars, exceeds the fair market value of the subdivision, 10,000*x* dollars, *X* realizes income from the discharge of indebtedness. However, under section 108(a)(1)(B) of the Code, the full amount of *X*'s discharge of indebtedness income is excluded from gross income because that amount does not exceed the amount by which *X* was insolvent.

If the subdivision had been transferred to the bank as a result of a foreclosure proceeding in which the outstanding balance of the debt was discharged (rather than having been transferred pursuant to the settlement agreement), the result would be the same. A mortgage foreclosure, like a voluntary sale, is a "disposition" within the scope of the gain or loss provisions of section 1001 of the Code. *See Helvering v. Hammel*, 311 U.S. 504 (1941), 1941-1 C.B. 375; *Electro-Chemical Engraving Co. v. Commissioner*, 311 U.S. 513 (1941), 1941-1 C.B. 380; and *Danenberg v. Commissioner*, 73 T.C. 370 (1979), *acq.*, 1980-2 C.B. 1.

HOLDING

The transfer of the subdivision by *X* to the bank in satisfaction of a debt on which *X* was personally liable is a sale or disposition upon which gain is realized and recognized by *X* under sections 1001(c) and 61(a)(3) of the Code to the extent the fair market value of the subdivision transferred exceeds *X*'s adjusted basis. Subject to the application of section 108 of the Code, to the extent the amount of debt exceeds the fair market value of the subdivision, *X* would also realize income from the discharge of indebtedness.

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26 CFR 1.61-21: Taxation of fringe benefits.

Fringe benefits; aircraft valuation formula. For purposes of section 1.61-21(g) of the regulations, relating to the rule for valuing noncommercial flights on employer-provided aircraft, the Standard Industry Fare Level (SIFL) cents-per-mile rates and the terminal charges in effect for 1989 are set forth. Rev. Rul. 88-71 modified.

Rev. Rul. 90-4

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61-21(g) of the Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61-21(g)(5) of the regulations sets forth an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61-21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are revised semi-annually.

The following chart sets forth the applicable terminal charges and SIFL mileage rates for 1989:

Period During Which the Flight Was Taken	*Terminal Charge*	*SIFL Mileage Rates*
1/1/89-6/30/89	$26.48	Up to 500 miles = $.1449 per mi
		501-1500 miles = $.1105 per mi
		Over 1500 miles = $.1062 per mi
7/1/89-12/31/89	$28.40	Up to 500 miles = $.1553 per mi
		501-1500 miles = $.1184 per mi
		Over 1500 miles = $.1139 per mi

EFFECT ON OTHER REVENUE RULING

Rev. Rul. 88-71, 1988-2 C.B. 29, is modified.

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26 CFR 1.61-21: Taxation of fringe benefits.

Fringe benefits; aircraft valuation formula. For purposes of section 1.61-21(g) of the regulations, relating to the rule for valuing noncommercial flights on employer-provided aircraft, the Standard Industry Fare Level (SIFL) cents-per-mile rates and the terminal charge in effect for flights taken during the first six months of 1990 are set forth. Rev. Rul. 90-4 modified.

Rev. Rul. 90-43

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61-21(g) of the Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61-21(g)(5) of the regulations sets forth an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61-21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are revised semi-annually.

The following chart sets forth the applicable terminal charges and SIFL mileage rates for flights taken during the first six months of 1990:

Period During Which the Flight Was Taken	*Terminal Charge*	*SIFL Mileage Rates*
1/1/90-6/30/90	$30.45	Up to 500 miles = $.1666 per mi
		501-1500 miles = $.1270 per mi
		Over 1500 miles = $.1221 per mi

EFFECT ON OTHER REVENUE RULING

Rev. Rul. 90-4, page 13, this Bulletin, is modified.

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62-1T: Adjusted gross income (temporary).

T.D. 8276

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR PARTS 1, 31, AND 602

Employee Business Expenses—Reporting and Withholding on Employee Business Expense Reimbursements and Allowances

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary and final regulations.

SUMMARY: This document contains temporary and final regulations concerning the taxation of and reporting and withholding on payments with respect to employee business expenses under a reimbursement or other expense allowance arrangement. These temporary regulations reflect changes to the law made by the Family Support Act of 1988. These temporary regulations will affect employees who receive payments and payors who make payments under reimbursement or other expense allowance arrangements. The text of the temporary regulations set forth in this document also serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in *** [EE-8-89, page 616, this Bulletin].

EFFECTIVE DATES: The provisions of these temporary regulations under §1.62-1T are effective for expenses paid or incurred in taxable years beginning before January 1, 1989. The income tax provisions of these temporary regulations under §1.62-2T are effective for taxable years beginning on or after January 1, 1989, with respect to expenses paid or incurred in taxable years beginning on or after January 1, 1989. The provisions of §1.162-17(e)(3) of these regulations are effective for taxable years beginning on or after January 1, 1989. The provisions of §1.274-5T(g) of these regulations are effective upon publication. The provisions of §1.162-25T of these regulations are effective upon publication. The reporting provisions of these temporary regulations under §1.6041-3(i) are effective for payments made under reimbursement or other expense allowance arrangements on or after January 1, 1989; however, a transition rule is provided under §1.6041-3(i) effective for payments made prior to January 1, 1990. The amendments to §§31.3121(a)-1(h), 31.3231(e)-1, 31.3306(b)-1, and 31.3401(a)-(1)(b)(2) of these regulations are effective for amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990. The provisions of these temporary regulations under §§31.3121(a)-2T, 31.3231(e)-3T, 31.3306(b)-2T, and 31.3401(a)-2T regarding withholding and payment of employment taxes are effective for payments made under reimbursement or other expense allowance arrangements on or after July 1, 1990.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

This regulation is being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in this regulation has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under control number 1545-1148. The estimated average annual burden per recordkeeper is 0.5 hour. This estimate is an approximation of the average time expected to be necessary for a collection of information. It is based on such information as is available to the Internal Revenue Service. Individual recordkeepers may require greater or less time, depending on their particular circumstances.

For further information concerning this collection of information, and where to submit comments on this collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referenced notice of proposed rulemaking published in *** [EE-8-89, page 616, this Bulletin].

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under sections 62, 162, 274 and 6041 of the Internal Revenue Code, and to the Employment Tax Regulations (26 CFR Part 31) under sections 3121, 3231, 3306, and 3401 of the Code as a result of the Family Support Act of 1988, Public Law No. 100-485 [1989-2 C.B. 338].

Need For Temporary and Final Regulations

Because of the need for immediate guidance regarding the reporting and withholding requirements of these regulations, it is impracticable and contrary to the public interest to issue these temporary and final regulations with notice and public procedure under section 553(b) of Title 5 of the United States Code, or subject to the effective date limitation of section 553(d) of Title 5.

Explanation of Provisions

Section 62(a) of the Internal Revenue Code generally defines "adjusted gross income" as gross income minus certain deductions. These "above-the-line" deductions are allowed without regard to whether a taxpayer itemizes deductions and are not subject to the two-percent floor of section 67. Among the above-the-line deductions, section 62(a)(2)(A) allows an employee a deduction for expenses (reimbursed employee business expenses) paid by the employee, in connection with the performance of services as an employee, under a reimbursement or other expense allowance arrangement with his or her employer. In addition, the above-the-line deduction is available for reimbursement or other expense allowance arrangements maintained by an agent of the employer or by a third party for whom the employee performs a service as an employee of the employer. Throughout these regulations, such employers, agents, and third parties are referred to as "payors."

As amended, section 62(c) provides that an arrangement will not be treat-

ed as a "reimbursement or other expense allowance arrangement" for purposes of section 62(a)(2)(A) unless—

1) the arrangement requires the employee to substantiate the expenses covered by the arrangement to the payor, and

2) the arrangement requires the employee to return any amount in excess of the substantiated expenses covered under the arrangement.

Reimbursement or Other Expense Allowance Arrangements

1. *Defined*

For purposes of the temporary regulations, a reimbursement or other expense allowance arrangement is an arrangement that meets three requirements: (1) business connection, (2) substantiation, and (3) returning amounts in excess of expenses.

2. *Business Connection Requirement*

An arrangement meets the business connection requirement under the temporary regulations if it provides reimbursements, advances, or allowances (including per diem allowances, allowances for meals and incidental expenses, and mileage allowances) for business expenses that are allowable as deductions for expenses paid or incurred by an employee in connection with the performance of services as an employee. The business connection requirement therefore requires a nexus between an amount denominated an "advance" and the business expenses that it is anticipated the employee will incur. For example, if an employer provides an employee with an "advance" of $3000 at a time when it is not anticipated that the employee will incur travel or other expenses deductible in the trade or business of being an employee, the "advance" does not meet the business connection requirement and will not be treated as paid under an accountable plan.

3. *Substantiation*

In order to meet the substantiation requirement, the employee must be required to substantiate the expenses covered by the arrangement to the payor. For example, to the extent employee business expenses covered by such arrangements are governed by the substantiation rules of section 274(d), the employee must meet the substantiation requirements of that section, which, for example, with respect to a travel expense, generally require substantiation of the amount, time, place and business purpose of the expense.

Under section 274(d), the Commissioner has the authority to provide simplified methods of substantiation. The Service is publishing several such simplified methods of substantiation. Under these simplified methods, known as "deemed substantiation" methods, employees are deemed to have substantiated an amount of expenses equal to the lesser of the amount of the reimbursement or the amount specified by the Service.

The methods of deemed substantiation available to employers will include methods applicable to lodging, meal and/or incidental expenses, both within and outside the continental United States, and methods applicable to reimbursement of transportation expenses. Such methods will include reimbursements paid under arrangements similar to the methods for reimbursing Federal employees. In addition, deemed substantiation methods will be available for reimbursements paid at a flat rate or under a stated schedule, such as reimbursements for lodging, meals and/or incidental expenses calculated on the basis of hours worked or miles driven.

The Service will, in a separate announcement, request suggestions from taxpayers concerning appropriate additional methods of deemed substantiation.

4. *Returning Amounts in Excess of Expenses*

In order to meet the requirement of returning amounts in excess of expenses, an arrangement must require the employee to return any amount in excess of the substantiated expenses covered under the arrangement. If an employee receives an advance for anticipated business expenses that exceeds the amount of such expenses actually incurred and substantiated by the employee, but the employee uses such excess to pay expenses incurred for other business expenses, the employee need not return such excess to the payor.

The temporary regulations grant the Commissioner the authority to prescribe rules under which an arrangement providing per diem allowances or mileage allowances will be treated as satisfying the requirement of returning amounts in excess of expenses, even though an employee is not required to return the portion of such an allowance that exceeds the amount of the employee's expenses which is deemed substantiated under rules prescribed under section 274(d), provided the allowance is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return any portion of such an allowance which relates to days or miles of travel not substantiated. For example, assume a payor provides an employee an advance mileage allowance of $60, based on an anticipated 200 business miles at 30 cents-per-mile (at a time when the applicable standard mileage rate is 26 cents-per-mile), and the employee substantiates 120 business miles. Under these rules, the requirement to return excess amounts will be treated as satisfied if the employee is required to return the amount of the advance allowance that is attributable to the 80 unsubstantiated business miles ($24.00), even though the employee is not required to return the portion of the allowance ($4.80) that exceeds the amount of the employee's expenses deemed substantiated ($31.20) pursuant to rules prescribed under section 274(d).

5. *Timeliness*

Both the requirement of substantiation and the requirement that excess reimbursements be returned must be met within a reasonable period of time after an expense is paid or incurred. What constitutes a reasonable period of time depends on the facts and circumstances. Thus, for example, it is reasonable that an employee who is on an extended travel assignment would have a longer period to substantiate expenses and return excess amounts than an employee who undertakes a single overnight trip.

The regulations provide two safe harbor methods. Under the first, the requirements will be treated as met within a reasonable period of time if an advance is made within 30 days of when an expense is paid or incurred, an expense is substantiated within 60 days after it is paid or incurred, or an excess amount is returned to the payor within 120 days after the expense is paid or incurred. Under the second,

the requirements will be treated as met within a reasonable period of time if an expense is substantiated or an amount is returned within 120 days after the payor provides a periodic statement (no less frequently than quarterly) of the amount paid under the arrangement that exceeds the expenses the employee has substantiated. Both methods are intended solely as safe harbors, and no adverse inference is intended with respect to amounts advanced, substantiated, or returned after such periods. However, for purposes of withholding, a payor may treat amounts substantiated or returned after such periods as not having been substantiated or returned within a reasonable period of time.

Reporting and Employment Taxes

The Conference Report on the Family Support Act of 1988 (H.R. Rep. No. 998, 100th Cong., 2d Sess. 202-206 (1988)) provides that the regulations and rulings regarding the reporting of employee business expense reimbursements and allowances generally are also to be revised to conform to the changes in section 62 and to subject amounts treated as paid pursuant to nonaccountable plans to income tax withholding. In addition, the legislative history provides authority to alter the relevant employment tax rules. Pursuant to the regulatory authority granted by Congress under the Family Support Act, these temporary regulations provide guidance regarding the circumstances under which travel and other expense allowance arrangements are subject to the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act (RRTA), the Railroad Unemployment Repayment Tax (RURT) and the Collection of Income Tax at Source on Wages ("employment taxes"). These regulations also provide guidance with regard to reporting of such amounts on Form W-2.

Delayed effective dates are provided for the changes in the employment tax regulations. The changes in the employment tax regulations are effective for payments made under reimbursement or other expense allowance arrangements that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990. For reimbursements or other expense allowance payments made before July 1, 1990, or made with respect to expenses paid or incurred before July 1, 1990, the rules in existing regulations will apply. Hence, for payments made under reimbursement or other expense allowance arrangements before July 1, 1990, no withholding or employment tax liability will attach with respect to amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer. Of course, as under existing regulations, such expenses must be identified either by making a separate payment or by specifically identifying the separate amounts if both wages and expense allowances are combined in a single payment.

A delayed effective date is not provided for the amendments to the reporting requirements under section 6041. The reporting requirements are effective for payments made under reimbursement or other expense allowance arrangements on or after January 1, 1989, with respect to expenses paid or incurred on or after January 1, 1989. However, for payments made before January 1, 1990, no reporting is required if the payor has made a reasonable, good faith effort to comply with the requirements of section 62(c). In general, compliance with the provisions of prior section 1.6041-3(i) of the Income Tax Regulations will indicate such reasonable good faith effort to comply with the requirements of section 62(c). Under those regulations, reporting on Form W-2 was not required if the employee was required to account and did so account to the employer for such expenses. See Rev. Rul. 80-62, 1980-1 C.B. 63, as modified, and Rev. Rul. 84-127, 1984-2 C.B. 246. A payor must, however, report payments made before January 1, 1990, if an arrangement (other than a per diem or mileage type arrangement) does not require the employee to substantiate expenses or to return excess amounts.

Payments Under Accountable Plans

If an arrangement meets all the requirements of the regulations, the amounts paid under the arrangement are excluded from the employee's gross income, are not required to be reported on the employee's Form W-2, and are exempt from withholding and payment of employment taxes (FICA, FUTA, RRTA, RURT, and income tax). If an arrangement meets the requirements of the regulations, but an employee fails to return amounts in excess of amounts substantiated, only the amounts not in excess of the substantiated expenses are excluded from the employee's gross income, are not required to be reported on the employee's Form W-2, and are exempt from withholding and payment of employment taxes (FICA, FUTA, RRTA, RURT, and income tax).

Payments Under Nonaccountable Plans

If an arrangement does not meet one or more of the requirements of the regulations, all payments under the arrangement are included in the employee's gross income, are reported as wages on Form W-2, and are wages for purposes of withholding and payment of employment taxes. If an arrangement meets the requirements of the regulations, but an employee fails to return amounts in excess of amounts substantiated, such excess is included in the employee's gross income, is reported as wages on Form W-2, and is wages for purposes of withholding and payment of employment taxes. Employee business expenses that exceed the amount of the reimbursements that are excluded from the employee's gross income are not allowable as a deduction in computing adjusted gross income. Rather, such employee business expenses are deductible by the employee in computing taxable income only if the employee itemizes deductions, and only to the extent that the total of such expenses and other miscellaneous itemized deductions exceeds two percent of the taxpayer's adjusted gross income.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to

these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Parts 1, 31, and 602 are amended as follows:

PART 1—[AMENDED]

Paragraph 1. The authority for Part 1 is amended by adding the following citations:

Authority: 26 U.S.C. 7805 *** Secs. 1.62–1T and 1.62–2T also issued under 26 U.S.C. 62 *** Sec. 1.6041–3 also issued under 26 U.S.C. 62.

Par. 2. Section 1.62–1T is amended by revising paragraph (c)(2) and by inserting a new sentence before the first sentence of paragraph (f), to read:

§1.62–1T Adjusted gross income (temporary).

* * * * *

(c) Deductions allowable in computing adjusted gross income. ***

(2) Deductions allowable under part VI, subchapter B, chapter 1 of the Code, (section 161 and following) that consist of expenses paid or incurred by the taxpayer in connection with the performance of services as an employee under an express reimbursement or other expense allowance arrangement (as defined in paragraph (f) of this section or §1.62–2T, whichever is applicable) with his or her employer;

* * * * *

(f) Reimbursement or other expense allowance arrangement. This paragraph (f) applies to expenses paid or incurred in taxable years beginning before January 1, 1989.***

* * * * *

Par. 3. Section 1.62-2T is added immediately following 1.62-1T to read as follows:

§1.62–2T *Reimbursements and other expense allowance arrangements (Temporary).*

(a) *Table of contents.* The contents of this section are as follows:

(a) *Table of contents.*

(b) *Scope.*

(c) *Reimbursement or other expense allowance arrangement.*

(1) *Defined.*

(2) *Accountable plans.*

(i) *In general.*

(ii) *Special rule for failure to return excess.*

(3) *Nonaccountable plans.*

(i) *In general.*

(ii) *Special rule for failure to return excess.*

(4) *Treatment of payments under accountable plans.*

(5) *Treatment of payments under nonaccountable plans.*

(d) *Business connection.*

(e) *Substantiation.*

(1) *In general.*

(2) *Expenses governed by section 274(d).*

(3) *Expenses not governed by section 274(d).*

(f) *Returning amounts in excess of expenses.*

(1) *In general.*

(2) *Per diem or mileage allowances.*

(g) *Reasonable period.*

(1) *In general.*

(2) *Safe harbors.*

(i) *Fixed date method.*

(ii) *Periodic payment method.*

(h) *Timing of withholding.*

(i) *Application.*

(j) *Cross references.*

(k) *Effective date.*

(b) *Scope.* For purposes of determining "adjusted gross income," section 62(a)(2)(A) allows an employee a deduction for expenses allowed by Part VI (section 161 and following), subchapter B, chapter 1 of the Code, paid by the employee, in connection with the performance of services as an employee, under a reimbursement or other expense allowance arrangement with a payor (the employer, its agent, or a third party). Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of section 62(a)(2)(A) if (1) such arrangement does not require the employee to substantiate the expenses covered by the arrangement to the payor, or (2) such arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement. This section prescribes rules relating to the requirements of section 62(c).

(c) *Reimbursement or other expense allowance arrangement*—(1) *Defined.* For purposes of §§1.62–1T and 1.62–2T, the phrase "reimbursement or other expense allowance arrangement" means an arrangement that meets the requirements of paragraphs (d) (business connection), (e) (substantiation), and (f) (returning amounts in excess of expenses) of this section. A payor may have more than one arrangement with respect to a particular employee, depending on the facts and circumstances.

(2) *Accountable plans*—(i) *In general.* Except as provided in paragraph (c)(2)(ii) of this section, if an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, all amounts paid under the arrangement are treated as paid under an "accountable plan."

(ii) *Special rule for failure to return excess.* If an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, but the employee fails to return, within a reasonable period of time, any amount in excess of the amount of the expenses substantiated in accordance with paragraph (e), only the amounts paid under the arrangement that are not in excess of the substantiated expenses are treated as paid under an accountable plan.

(3) *Nonaccountable plans*—(i) *In general.* If an arrangement does not satisfy one or more of the requirements of paragraphs (d), (e), or (f) of this section, all amounts paid under the arrangement are treated as paid under a "nonaccountable plan."

(ii) *Special rule for failure to return excess.* If an arrangement meets the requirements of paragraphs (d), (e), and (f) of this section, but the employee fails to return, within a reasonable period of time, any amount in excess of the amount of the expenses substantiated in accordance with paragraph (e), the amounts paid under the arrangement that are in excess of the substantiated expenses are treated as paid under a nonaccountable plan.

(4) *Treatment of payments under accountable plans.* Amounts treated as paid under an accountable plan are excluded from the employee's gross income, are not required to be reported on the employee's Form W-2, and are exempt from the withholding and payment of employment taxes (Federal Insurance Contributions Act (FICA), Federal Unemployment Tax Act (FUTA), Railroad Retirement Tax Act (RRTA), Railroad Unemployment Repayment Tax (RURT), and income tax). See paragraph (j) of this §1.62-2T for cross references.

(5) *Treatment of payments under nonaccountable plans.* Amounts treated as paid under a nonaccountable plan are included in the employee's gross income, must be reported to the employee on Form W-2, and are subject to withholding and payment of employment taxes (FICA, FUTA, RRTA, RURT, and income tax). Expenses attributable to amounts included in the employee's gross income may be deducted, provided the employee can substantiate the full amount of his or her expenses (i.e., the amount of the expenses, if any, the reimbursement for which is treated as paid under an accountable plan as well as those for which the employee is claiming the deduction) in accordance with §1.274-5T or §1.162-17, but only as a miscellaneous itemized deduction subject to the limitations applicable to such expenses (e.g., the 80-percent limitation on meal and entertainment expenses provided in section 274(n) and the 2-percent floor provided in section 67).

(d) *Business connection.* An arrangement meets the requirements of this paragraph (d) if it provides advances, allowances (including per diem allowances, allowances for meals and incidental expenses, and mileage allowances), or reimbursements for business expenses that are allowable as deductions by Part VI (section 161 and the following), subchapter B, chapter 1 of the Code, and that are paid or incurred by the employee in connection with the performance of services as an employee. The payment may be actually received from the employer, its agent, or a third party for whom the employee performs a service as an employee of the employer, and may include amounts charged directly or indirectly to the payor through credit card systems or otherwise. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(e) *Substantiation*—(1) *In general.* An arrangement meets the requirements of this paragraph (e) if it requires each business expense to be substantiated to the payor in accordance with paragraph (e)(2) or (e)(3) of this section, whichever is applicable, within a reasonable period of time. See §1.274-5T or §1.162-17.

(2) *Expenses governed by section 274(d).* An arrangement that reimburses travel, entertainment, use of a passenger automobile or other listed property, or other business expenses governed by section 274(d) meets the requirements of this paragraph (e)(2) if information sufficient to satisfy the substantiation requirements of section 274(d) and the regulations thereunder is submitted to the payor. See §1.274-5T. Under section 274(d), information sufficient to substantiate the requisite elements of each expenditure or use must be submitted to the payor. For example, with respect to travel away from home, §1.274-5T(b)(2) requires that information sufficient to substantiate the amount, time, place, and business purpose of the expense must be submitted to the payor. Similarly, with respect to use of a passenger automobile or other listed property, §1.274-5T(b)(6) requires that information sufficient to substantiate the amount, time, use, and business purpose of the expense must be submitted to the payor. See §1.274-5T(g), however, which grants the Commissioner authority to prescribe rules permitting the amount of certain expenses to be deemed substantiated to the payor (in lieu of substantiating the actual amount of such expenses) where an arrangement provides for a reimbursement, a per diem allowance, or a mileage allowance for travel away from home or transportation expenses. See also §1.274-5T(j), which grants the Commissioner the authority to establish a method under which a taxpayer may elect to use a specified amount for meals while traveling away from home in lieu of substantiating the actual cost of meals. Substantiation of the amount of a business expense in accordance with rules prescribed pursuant to the authority granted by §1.274-5T(g) or §1.274-5T(j) will be treated as substantiation of the amount of such expense for purposes of this section.

(3) *Expenses not governed by section 274(d).* An arrangement that reimburses business expenses not governed by section 274(d) meets the requirements of this paragraph (e)(3) if information is submitted to the payor sufficient to enable the payor to identify the specific nature of each expense and to conclude that the expense is attributable to the payor's business activities. Therefore, each of the elements of an expenditure or use must be substantiated to the payor. It is not sufficient if an employee merely aggregates expenses into broad categories (such as "travel") or reports individual expenses through the use of vague, nondescriptive terms (such as "miscellaneous business expenses"). See §1.162-17(b).

(f) *Returning amounts in excess of expenses*—(1) *In general.* Except as provided in paragraph (f)(2) of this section, an arrangement meets the requirements of this paragraph (f) if it requires the employee to return to the payor within a reasonable period of time any amount paid under the arrangement in excess of the expenses substantiated in accordance with paragraph (e) of this section. The determination of whether an arrangement requires an employee to return amounts in excess of substantiated expenses will depend on the facts and circumstances. An arrangement whereby money is advanced to an employee to defray expenses will be treated as satisfying the requirements of this paragraph (f) only if the amount of money advanced is reasonably calculated not to exceed the amount of anticipated expenditures, the advance of money is made on a day within a reasonable period of the day that the anticipated expenditures are paid or incurred, and any amounts in excess of the expenses substantiated in accordance with paragraph (e) are required to be re turned to the payor within a reasonable period of time after the advance is received.

(2) *Per diem or mileage allowances.* The Commissioner may, in his discretion, prescribe rules in pronouncements of general applicability under which a reimbursement or other expense allowance arrangement that provides per diem allowances providing for ordinary and necessary expenses of traveling away from home (exclusive of transportation costs to and from destination) or mileage allowances providing for ordinary and necessary expenses of local travel and transportation while traveling away from home will be treated as satisfying the requirements of this paragraph (f), even though the arrangement does not require the employee to return the portion of such an allowance that exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under section 274(d), provided the allowance is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return to the payor within a reasonable period of time any portion of such allowance which relates to days or miles of travel not substantiated in accordance with paragraph (e) of this section.

(g) *Reasonable period*—(1) *In general.* The determination of a reasonable period of time will depend on the facts and circumstances.

(2) *Safe harbors*—(i) *Fixed date method.* An advance made within 30 days of when an expense is paid or incurred, an expense substantiated to the payor within 60 days after it is paid or incurred, or an amount returned to the payor within 120 days after an expense is paid or incurred will be treated as having occurred within a reasonable period of time.

(ii) *Periodic statement method.* If a payor provides employees with periodic statements (no less frequently than quarterly) stating the amount, if any, paid under the arrangement in excess of the expenses the employee has substantiated in accordance with paragraph (e) of this section, and requesting the employee to substantiate any additional business expenses that have not yet been substantiated (whether or not such expenses relate to the expenses with respect to which the original advance was paid) and/or to return any amounts remaining unsubstantiated within 120 days of the statement, an expense substantiated or an amount returned within that period will be treated as being substantiated or returned within a reasonable period of time.

(h) *Timing of withholding.* If the expenses covered under an arrangement are not substantiated to the payor in accordance with paragraph (e) of this section within a reasonable period of time or if any amounts in excess of the substantiated expenses are not returned to the payor in accordance with paragraph (f) of this section within a reasonable period of time, the amount which is treated as paid under a nonaccountable plan under paragraph (c)(3) of this section is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. A payor may treat any amount not substantiated or returned within the periods specified in paragraph (g)(2) of this section as not substantiated or returned within a reasonable period of time. See paragraph (j) of this §1.62-2T for cross references.

(i) *Application.* The requirements of paragraphs (d) (business connection), (e) (substantiation), and (f) (returning amounts in excess of expenses) of this section will be applied on an employee-by-employee basis. Thus, for example, the failure by one employee to substantiate expenses under an arrangement in accordance with paragraph (e) will not cause amounts paid to other employees to be treated as paid under a nonaccountable plan.

(j) *Cross references.* For employment tax regulations relating to reimbursement and expense allowance arrangements, see §§31.3121(a)-1(h), 31.3231(e)-1(a)(3)(iv), 31.3306(b)-1(h), and 31.3401(a)-(1)(b)(2), which apply to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990. For reporting requirements, see §1.6041-3(i), which generally applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after January 1, 1989 with respect to expenses paid or incurred on or after January 1, 1989.

(k) *Effective date.* This section applies to payments made under reimbursement or other expense allowance arrangements received by an employee in taxable years of the employee beginning on or after January 1, 1989, with respect to expenses paid or incurred in taxable years beginning on or after January 1, 1989.

Par. 4. In §1.162-17, a new paragraph (e)(3) is added, to read as follows:

§1.162-17 Reporting and substantiation of certain business expenses of employees.

* * * * *

(e) *Applicability.* ***

(3) For taxable years beginning on or after January 1, 1989, the provisions of this section are superseded by the regulations under section 62(c) to the extent this section is inconsistent with those regulations. See §1.62-2T.

Par. 5. Paragraph (b) of section 1.162-25T is amended by removing the first sentence and adding in its place three new sentences to read as follows:

§1.162-25T Deductions with respect to noncash fringe benefits (temporary).

* * * * *

(b) *Employee.* If an employer provides the use of a vehicle (as defined in §1.61-21(e)(2)) to an employee as a noncash fringe benefit and includes the entire value of the benefit in an employee's gross income without taking into account any exclusion for a working condition fringe allowable under section 132 and the regulations thereunder, the employee may deduct that value multiplied by the percentage of the total use of the vehicle that is in connection with the employer's trade or business ("business value"). For taxable years beginning before January 1, 1990, the employee may deduct the business value from gross income in determining adjusted gross income. For taxable years beginning on or after January 1, 1990, the employee may deduct the business value only as a miscellaneous itemized deduction in determining taxable income, subject to the 2-percent floor provided in section 67. ***

* * * * *

Par. 6. Paragraph (g) of §1.274-5T is revised by adding the words "in pronouncements of general applicabil-

ity" immediately following the word "rules" in the first sentence, effective upon publication.

Par. 7. In §1.6041-3, paragraph (i) is revised to read as follows:

§1.6041-3 Payments for which no return of information is required under section 6041.

* * * * *

(i)—(1) *In general.* Payments made under reimbursement or other expense allowance arrangements that meet the requirements of section 62(c) of the Code and §1.62-2T, that do not exceed the amount of the expenses substantiated (i.e., amounts which are treated as paid under an accountable plan), and that are received by an employee on or after January 1, 1989, with respect to expenses paid or incurred on or after January 1, 1989;

(2) *Transition rule.* Payments made under reimbursement or other expense allowance arrangements that are received by an employee on or after January 1, 1989, but prior to January 1, 1990, to the extent that the employee is required to account (within the meaning of the term "account" as set forth in §1.162-17(b)(4) or 1.274-5T(f)(4), whichever is applicable) and does so account to the payor for such expenses, provided the payor has made a reasonable, good faith effort to comply with the requirements of section 62(c). In general, compliance with the provisions of this section, as in effect for payments made under reimbursement or other expense allowance arrangements that were received by an employee before January 1, 1989, with respect to expenses paid or incurred before January 1, 1989, will constitute such reasonable good faith compliance. In no event, however, will reasonable good faith compliance exist if a payor fails to report payments made under an arrangement (other than a per diem or mileage allowance type arrangement) under which an employee is not required to substantiate expenses paid or incurred or is not required to return amounts in excess of the substantiated expenses;

* * * * *

PART 31—[AMENDED]

Par. 8. The authority for Part 31 is amended by adding the following citation:

Authority: 26 U.S.C. 7805 *** Secs. 31.3121(a)-1, 31.3231(e)-1, 31.3306(b)-1, and 31.3401(a)-1 also issued under 26 U.S.C. 62.

Par. 9. In §31.3121(a)-1, paragraph (h) is amended by adding a sentence at the end to read as follows:

§31.3121(a)-1 Wages.

* * * * *

(h) *** For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see §31.3121(a)-2T.

* * * * *

Par. 10. Section 31.3121(a)-2T is added to read as follows:

§31.3121(a)-2T Reimbursement and other expense allowance amounts—(a) *When excluded from wages.* If a reimbursement or other expense allowance arrangement meets the requirements of section 62(c) of the Code and §1.62-2T and the expenses are substantiated within a reasonable period of time, payments made under the arrangement that do not exceed the substantiated expenses are treated as paid under an accountable plan and are not wages. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(b) *When included in wages.* If a reimbursement or other expense allowance arrangement does not satisfy the requirements of section 62(c) and §1.62-2T (e.g., the arrangement does not require expenses to be substantiated or require amounts in excess of the substantiated expenses to be returned), all amounts paid under the arrangement are treated as paid under a nonaccountable plan, are included in wages, and are subject to withholding and payment of employment taxes when paid. If an arrangement satisfies the requirements of section 62(c) and §1.62-2T, but the expenses are not substantiated within a reasonable period of time or amounts in excess of the substantiated expenses are not returned within a reasonable period of time, the amount paid under the arrangement in excess of the substantiated expenses is treated as paid under a nonaccountable plan, is included in wages, and is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period.

(c) *Effective date.* This section applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990.

Par. 11. In §31.3231(e)-1, paragraph (a)(3)(iv) is amended by adding a sentence at the end to read as follows:

§31.3231(e)-1 Compensation.

(a) ***

(iv) *** For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see §31.3231(e)-3T.

Par. 12. Section 31.3231(e)-3T is added to read as follows:

§31.3231(e)-3T Reimbursement and other expense allowance amounts—(a) *When excluded from compensation.* If a reimbursement or other expense allowance arrangement meets the requirements of section 62(c) of the Code and §1.62-2T and the expenses are substantiated within a reasonable period of time, payments made under the arrangement that do not exceed the substantiated expenses are treated as paid under an accountable plan and are not compensation. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(b) *When included in compensation.* If a reimbursement or other expense allowance arrangement does not satisfy the requirements of section 62(c) and §1.62-2T (e.g., the arrangement does not require expenses to be substantiated or require amounts in excess of the substantiated expenses to be returned), all amounts paid under the arrangement are treated as paid under a nonaccountable plan, are included in compensation, and are subject to withholding and payment of employment taxes when paid. If an arrangement satisfies the requirements

of section 62(c) and §1.62-2T, but the expenses are not substantiated within a reasonable period of time or amounts in excess of the substantiated expenses are not returned within a reasonable period of time, the amount paid under the arrangement in excess of the substantiated expenses is treated as paid under a nonaccountable plan, is included in compensation, and is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period.

(c) *Effective date.* This section applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990.

Par. 13. In §31.3306(b)-1, paragraph (h) is amended by adding a sentence at the end to read as follows:

§31.3306(b)-1 Wages.

* * * * *

(h) *** For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see §31.3306(b)-2T.

* * * * *

Par. 14. Section 31.3306(b)-2T is added to read as follows: *§31.3306(b)-2T Reimbursement and other expense allowance amounts*—(a) *When excluded from wages.* If a reimbursement or other expense allowance arrangement meets the requirements of section 62(c) of the Code and §1.62-2T and the expenses are substantiated within a reasonable period of time, payments made under the arrangement that do not exceed the substantiated expenses are treated as paid under an accountable plan and are not wages. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(b) *When included in wages.* If a reimbursement or other expense allowance arrangement does not satisfy the requirements of section 62(c) and §1.62-2T (e.g., the arrangement does not require expenses to be substantiated or require amounts in excess of the substantiated expenses to be returned), all amounts paid under the arrangement are treated as paid under a nonaccountable plan, are included in wages, and are subject to withholding and payment of employment taxes when paid. If an arrangement satisfies the requirements of section 62(c) and §1.62-2T, but the expenses are not substantiated within a reasonable period of time or amounts in excess of the substantiated expenses are not returned within a reasonable period of time, the amount paid under the arrangement in excess of the substantiated expenses is treated as paid under a nonaccountable plan, is included in wages, and is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period.

(c) *Effective date.* This section applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990.

Par. 15. In §31.3401(a)-1, paragraph (b)(2) is amended by adding a sentence at the end to read as follows:

§31.3401(a)-1 Wages.

* * * * *

(b) ***

(2) *Traveling and other expenses.* *** For amounts that are received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990, see §31.3401(a)-2T.

* * * * *

Par. 16. Section 31.3401(a)-2T is added to read as follows: *§31.3401(a)-2T Reimbursements and other expense allowance amounts*—(a) *When excluded from wages.* If a reimbursement or other expense allowance arrangement meets the requirements of section 62(c) of the Code and §1.62-2T and the expenses are substantiated within a reasonable period of time, payments made under the arrangement that do not exceed the substantiated expenses are treated as paid under an accountable plan and are not wages. In addition, if both wages and the reimbursement or other expense allowance are combined in a single payment, the reimbursement or other expense allowance must be identified either by making a separate payment or by specifically identifying the amount of the reimbursement or other expense allowance.

(b) *When included in wages.* If a reimbursement or other expense allowance arrangement does not satisfy the requirements of section 62(c) and §1.62-2T (e.g., the arrangement does not require expenses to be substantiated or require amounts in excess of the substantiated expenses to be returned), all amounts paid under the arrangement are treated as paid under a nonaccountable plan, are included in wages, and are subject to withholding and payment of employment taxes when paid. If an arrangement satisfies the requirements of section 62(c) and §1.62-2T, but the expenses are not substantiated within a reasonable period of time or amounts in excess of the substantiated expenses are not returned within a reasonable period of time, the amount paid under the arrangement in excess of the substantiated expenses is treated as paid under a nonaccountable plan, is included in wages, and is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period.

(c) *Withholding rate.* Employers may add any payments made under reimbursement or other expense allowance arrangements that are subject to income tax withholding to the employee's regular wages for a payroll period and compute withholding taxes on the total. Alternatively, the employer may withhold income tax from the reimbursement or other expense allowance at the flat 20-percent rate applicable to supplemental wages, provided the employer withholds income tax from the employee's regular wages and provided the reimbursement or allowance is paid separately (or separately identified if wages and reimbursement amounts are combined in a single payment). See §31.3402(g)-1 regarding supplemental wage payments.

(d) *Effective date.* This section applies to payments made under reimbursement or other expense allowance arrangements received by an employ-

ee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990.

PART 602—[AMENDED]

Par. 17. The authority for Part 602 continues to read as follows:

26 U.S.C. 7805

Par. 18. Section 602.101(c) is revised by inserting in the appropriate places in the table " 1.62-2 . . . 1545-1148".

Fred T. Goldberg,
Commissioner of Internal Revenue.

Approved December 4, 1989.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 7, 1989, 12:20 p.m., and published in the issue of the Federal Register for December 12, 1989, 54 F.R. 51021)

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26 CFR 1.62-2T: Reimbursements and other expense allowance arrangements (temporary).

Self-employed individuals and employees may use the federal meal and incidental expense rate to compute the amount allowable as a deduction for business meal and incidental expenses paid or incurred while traveling away from home. See Rev. Proc. 90-15, page 476.

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26 CFR 1.62-2T: Reimbursements and other expense allowance arrangements (temporary).

The revenue procedure provides rules under which the amount of ordinary and necessary expenses paid or incurred by an employee in driving an automobile in connection with the performance of services as an employee of the employer will be deemed substantiated under section 1.274-5T of the temporary regulations when a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. See Rev. Proc. 90-34, page 552.

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26 CFR 1.62-2T: Reimbursements and other expense allowance arrangements (temporary).

Whether amounts paid as a reimbursement or other expense allowance for daily transportation expenses to a temporary work location are excludable from an employee's gross income pursuant to section 62(a)(2)(A) of the Code and section 1.62-2T of the Temporary Income Tax Regulations. See Rev. Rul. 90-23, page 28.

Section 63.—Taxable Income Defined

26 CFR 1.63-1: Change of treatment with respect to the zero bracket amount and itemized deductions.

The Service is providing inflation adjustments to the standard deduction amounts (including the $500 limitation in the case of certain dependents, and $600 or $750 additional standard deduction for the aged or blind) for taxable years beginning in 1990. See Rev. Proc. 90-7, page 432.

Part III.—Items Specifically Excluded from Gross Income

Section 103.—Interest on State and Local Bonds

26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

Rev. Proc. 89-59 is modified with respect to (1) the average area purchase price safe harbor limitation that may be used for an omitted category of residence (new or existing), and (2) the effective date of national average purchase prices and average area purchase price safe harbor limitations. See Rev. Proc. 90-24, page 510.

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26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

Guidance is provided for the use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio described in section 143(f)(5) of the Code. See Rev. Proc. 90-25, page 511.

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26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

The payment of issuance costs for an issue of private activity bonds from proceeds of the issue is not a qualifying use of bond proceeds for purposes of section 142(a) of the Code. See Rev. Rul. 90-51, this page.

Section 108.—Income from Discharge of Indebtedness

26 CFR 1.108(a)-1: Income from discharge of indebtedness.

If an insolvent taxpayer transfers to a creditor property with a fair market value in excess of basis in satisfaction of a debt on which the taxpayer is personally liable and which is secured by the property, does such transfer result in the recognition of gain. See Rev. Rul. 90-16, page 12.

Part IV.—Tax Exemption Requirements for State and Local Bonds

Subpart A.—Private Activity Bonds

Section 141.—Private Activity Bond; Qualified Bond

The payment of issuance costs for an issue of private activity bonds from proceeds of the issue is not a qualifying use of bond proceeds for purposes of section 142(a) of the Code. See Rev. Rul. 90-51, this page.

Section 142.—Exempt Facility Bond

Section 4.01(5) of Rev. Proc. 90-3, page 402, this Bulletin, relating to areas under former section 103(b) of the Code for which rulings will not ordinarily be issued by the Service, is modified to reflect changes resulting from the enactment of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 519. See Rev. Proc. 90-35, page 555.

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26 CFR 1.103-8: Interest on bonds to finance certain exempt facilities.
(Also Sections 103, 141; 1.103-1.)

Private activity bonds; issuance costs. The payment of issuance costs for an issue of private activity bonds from proceeds of the issue is not a qualifying use of bond proceeds for purposes of section 142(a) of the Code. Rev. Rul. 80-171 obsoleted.

Rev. Rul. 90-51

ISSUE

If issuance costs with respect to an issue of private activity bonds are paid from proceeds of the issue, how are the issuance costs treated for purposes of determining, under section 142(a) of the Internal Revenue Code, whether 95 percent or more of the net proceeds of the bonds are used to provide a facility described in section 142(a) (exempt facility)?

FACTS

A state issued private activity bonds with a face amount of $100x$ dollars that were sold to the general public at par. The state immediately loaned all $100x$ dollars of proceeds to *Y*, a for-profit corporation. *Y* used $85x$ dollars of bond proceeds to acquire a newly constructed exempt facility and $3x$ dollars of bond proceeds to acquire property that is not part of an exempt facility. *Y* also used $2x$ dollars of bond proceeds to pay issuance costs and $10x$ dollars of bond

proceeds to establish a reasonably required reserve or replacement fund within the meaning of section 148(d) of the Code.

If 95 percent or more of the net bond proceeds were used to provide an exempt facility as required by section 142(a) of the Code, then interest on the bonds would be tax exempt because the bonds satisfied all of the other requirements for tax exemption under section 103(a).

LAW AND ANALYSIS

Section 103(a) of the Code provides that, except as provided in section 103(b), gross income does not include interest on any state or local bond. Section 103(b)(1) provides that section 103(a) shall not apply to any private activity bond that is not a "qualified bond" within the meaning of section 141. Section 141(e)(1)(A) provides that the term "qualified bond" includes any private activity bond if such bond is an exempt facility bond.

Section 142(a) of the Code provides that the term "exempt facility bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide any exempt facility described in section 142(a).

Section 150(a)(3) of the Code provides that the term "net proceeds" means, with respect to any issue, the proceeds of such issue reduced by amounts in a reasonably required reserve or replacement fund.

Rev. Rul. 80-171, 1980-2 C.B. 44, holds that, for purposes of determining whether substantially all (90 percent or more) of bond proceeds are used to provide exempt facilities described in former section 103(b)(4) of the Code, bond proceeds are reduced by both the amount of the issuance costs and the amount of the reserve fund.

The Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 519, reorganized and amended the law governing tax-exemption for interest on obligations issued by or on behalf of governmental units. As part of these amendments, the Act changed the requirement concerning the percentage of bond proceeds which must be used to provide an exempt facility in order for the bond to be considered a qualified bond. Former section 103(b)(4) of the Code required that "substantially all of the proceeds" of an issue of bonds (defined in section 1.103-8(a)(1)(i) of the regulations as 90 percent or more) be used to provide an exempt facility described in section 103(b)(4). Section 142(a) now requires that 95 percent or more of the "net proceeds" of a bond issue be used to provide an exempt facility.

The Conference Report for the Tax Reform Act of 1986, 2 H.R. Conf. Rep. No. 841, 99th Cong., 2nd Sess. II-697, -729 (1986), 1986-3 (Vol. 4) C.B. 697, 729, states that the term "net proceeds" as defined in section 150(a)(3) of the Code means proceeds of the bonds less proceeds of the bonds deposited in a reasonably required reserve or replacement fund, and that therefore, bond proceeds used to pay issuance costs must be treated as paid from the 5 percent "bad money" portion of the issue.

In the present situation, 85x dollars of bond proceeds was used to acquire the newly constructed exempt facility. That is a qualifying use of the bond proceeds. The 2x dollars of the bond proceeds used to pay issuance costs and the 3x dollars of bond proceeds used to acquire property that is not part of an exempt facility were not used for a qualifying use. The net proceeds of the bonds for purposes of the 95 percent requirement under section 142(a) of the Code equal 90x dollars (100x dollars less 10x dollars of bond proceeds deposited in the reasonably required reserve or replacement fund). Because the 85x dollars used to provide the exempt facility does not equal or exceed 85.5x dollars (95 percent of 90x dollars), the 95 percent requirement under section 142(a) is not satisfied.

HOLDING

Bond proceeds used to pay issuance costs are not used for a qualifying use. Accordingly, less than 95 percent of the net bond proceeds was used to provide an exempt facility described in section 142(a) of the Code. The bonds are not exempt facility bonds within the meaning of sections 141(e)(1)(A) and 142, and the interest on the bonds is not excludable from gross income under section 103(a).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 80-171 is obsolete with respect to exempt facility bonds issued after August 15, 1986 (subject to transitional rules contained in sections 1312-1318 of the Tax Reform Act of 1986, as amended by section 1013 of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3537).

Section 143.—Mortgage Revenue Bonds: Qualified Mortgage Bond and Qualified Veterans' Mortgage Bond

26 CFR 6a.103A-2: Qualified mortgage bond.

Rev. Proc. 89-59, 1989-2 C.B. 771, is modified with respect to (1) the average area purchase price safe harbor limitation that may be used for an omitted category of residence (new or existing), and (2) the effective date of national average purchase prices and average area purchase price safe harbor limitations. See Rev. Proc. 90-24, page 510.

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26 CFR 6a.103A-2: Qualified mortgage bond.

Guidance is provided for the use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio described in section 143(f)(5) of the Code. See Rev. Proc. 90-25, page 511.

Section 144.—Qualified Small Issue Bond; Qualified Student Loan Bond; Qualified Redevelopment Bond

Section 4.01(5) of Rev. Proc. 90-3, page 402, this Bulletin, relating to areas under former section 103(b) of the Code for which rulings will not ordinarily be issued by the Service, is modified to reflect changes resulting from the enactment of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 519. See Rev. Proc. 90-35, page 555.

Subpart B.—Requirements Applicable to All State and Local Bonds

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Section 148.—Arbitrage

26 CFR 1.148-1T: Required rebate to the United States (temporary).

Issuers of state or local bonds are provided guidance for filing (1) a request for an extension of time to pay a correction amount of arbitrage rebate, (2) an explanation of an innocent failure to meet a requirement or payment of arbitrage rebate, or (3) a request for a ruling regarding a failure (other than an innocent failure) to meet a requirement for payment or arbitrage rebate. See Rev. Proc. 90-11, page 469.

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26 CFR 1.148-10: Purpose investments.

T.D. 8284

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Arbitrage Restrictions on Qualified Student Loan Bonds

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to arbitrage restrictions on qualified student loan bonds. Changes to the applicable law were made by the Tax Reform Act of 1984 and the Tax Reform Act of 1986. The regulations provide guidance on how to compute the yield on student loans.

DATES: The regulations are effective for qualified student loan bonds issued after January 5, 1990.

SUPPLEMENTARY INFORMATION:

Background

This document amends the Income Tax Regulations (26 CFR Part 1) to provide rules under section 148 of the Internal Revenue Code relating to arbitrage restrictions on qualified student loan bonds. On July 5, 1989, the Federal Register published proposed amendments (54 FR 28075) [FI-80-86, 1989-2 C.B. 817] to the Income Tax Regulations. This document adopts final regulations based on the notice of proposed rulemaking published on July 5, 1989.

Twenty-seven written comments responding to the notice of proposed rulemaking were received. In addition, seven persons provided oral comments at a public hearing held on December 13, 1989. After Treasury and Service consideration of all the comments received, the proposed amendments are adopted as revised by this Treasury decision.

Public Comments

Several commentators disagreed with the treatment in the proposed regulations of special allowance payments made by the Secretary of Education pursuant to section 438 of the Higher Education Act of 1965. The proposed regulations provided that these payments were to be taken into account in determining the yield on guaranteed student loans.

Section 625 of the Tax Reform Act of 1984 (98 Stat. 924) [Pub. L. 98-369, 1984-3 C.B. (Vol. 1) 1, 432] provides that the Treasury Department shall prescribe regulations that specify the circumstances under which a qualified student loan bond shall be treated as an arbitrage bond and that these regulations may require special allowance payments to be taken into account in determining yields on student loan notes (notwithstanding the special rule in former section 103(c)(5) that provided the contrary). In section 1301 of the Tax Reform Act of 1986 (100 Stat. 2602 [Pub. L. 99-514, 1986-3 C.B. (Vol. 1) 1, 519], Congress eliminated the special rule of former section 103(c)(5) and added section 148(g) to the Code, which provides that, except to the extent otherwise provided in regulations, special allowance payments are not to be taken into account in determining yields on student loan notes for purposes of section 148(a)(1). Section 5052 of the Technical and Miscellaneous Revenue Act of 1988 (102 Stat. 3677) provides that if the Treasury Department fails to exercise its regulatory authority under section 625 of the Tax Reform Act of 1984 and section 148(g) of the Code by July 1, 1989, it must report to Congress the reasons for not doing so. Through this series of enactments, Congress in effect required the Treasury Department to exercise its regulatory authority to include special allowance payments in the computation of yield on student loan notes or explain its failure to do so. After review of the Congressional Budget Office ("CBO") study discussed below and all the comments received, the final regulations adopt the rule of the proposed regulations requiring the inclusion of special allowance payments in the computation of yield on student loan notes.

Section 1.103-13(b)(5)(viii) provides that the yield on a student loan that is treated as an acquired program obligation is materially higher than the yield on an issue if the yield on the obligation exceeds the yield on the issue by more than one and one-half percentage points. The proposed regulations increased the permissible arbitrage spread on student loans from one and one-half percentage points to two percentage points to reflect the higher costs of administering student loan programs relative to most other loan programs. Notwithstanding this increase in the permissible spread, some commentators stated that the spread was still insufficient to cover issuance, servicing, and administrative costs associated with student loans.

After having studied a 1986 report issued by the CBO, the Treasury Department and the Service have concluded that an arbitrage spread of two percentage points is sufficient to cover the costs of administering most student loan programs. See generally Congressional Budget Office, "The Tax-Exempt Financing of Student Loans" 55-56 (Aug. 1986). However, the commentators argued that the study is based on statistical data that is several years old and, therefore, does not reflect the realities of current market conditions.

The final regulations adopt the increase in the permissible arbitrage spread from one and one-half to two percentage points provided under the proposed regulations. The increase in the permissible arbitrage spread to two percentage points is based on the CBO study, the only reliable information available to the Service on this issue. Several commentators stated that an independent study concerning costs of administering student loan programs has been commissioned by certain industry groups and that the study will be based on more accurate data than that relied upon in the CBO study. The Service understands that the results of this study will not be available in the near future. The Service welcomes the opportunity to review any data relating to this issue and may reconsider the sufficiency of the two-percentage-point permissible arbitrage spread.

The final regulations adopt the rule of the proposed regulations, under which the yield on a student loan may be increased to a level sufficient to cover all necessary expenses allocable to the loan. Thus, if the two-percentage-point arbitrage spread is insufficient to cover the amount of necessary expenses allocable to the loan, an issuer may substitute that larger amount in lieu of two percentage points. Although commentators

stated that allocating expenses to loans may be burdensome, the Service has received no specific comments on difficulties that may arise in this regard. The Service welcomes comments on this issue.

In response to several comments, the final regulations clarify that issuers continue to have the option of treating student loans as nonprogram, acquired purpose obligations, which are subject to a one-eighth-of-one-percentage-point arbitrage spread under §1.103-13(b)(5)(i). The final regulations also clarify that "administrative costs" include (as under §1.103-13(c)(5)(iv)(A) and (B)) the underwriter's spread.

In response to many comments, proposed and temporary regulations are being published in this issue of the Federal Register setting forth procedures under which issuers may be permitted to comply with the arbitrage yield limitations on student loans by paying to the United States any amounts necessary to reduce the yield on these loans to a yield that is not materially higher than the yield on the issue. Because proposed and temporary regulations address this issue, §1.148-10(b)(2)(ii) of the proposed regulations is not included in the final regulations.

Effective Date

The regulations are generally effective for qualified student loan bonds issued after January 5, 1990. The regulations do not apply to a bond issued exclusively to refund a qualified student loan bond if (1) the refunded bond was issued before January 5, 1990, (2) the amount of the refunding bond does not exceed 101 percent of the amount of the refunded bond, and (3) the maturity date of the refunding bond is not later than the date 17 years after the date of issue of the refunded bond (or, in the case of a series of refundings, the date of issue of the original bond).

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

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Adoption of Amendments to the Regulations

The amendments to 26 CFR Part 1 are as follows:

PART 1—[AMENDED]

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. ***Section 1.148-10 also issued under 26 U.S.C. 148(g) and (i) and 98 Stat. 924.

Par. 2. The following new section 1.148-10 is added in the appropriate place:

§1.148-10 Purpose investments.

(a) *General rule.* [Reserved]

(b) *Special rules for student loans*—(1) *Program loans*—(i) *Materially higher.* The yield on student loans that are treated as acquired program obligations within the meaning of §1.103-13(h) (rather than as nonprogram, acquired purpose obligations for purposes of §1.103-13(b)(5)(i)) and are allocated to the proceeds of an issue is not materially higher than the yield on the issue if the yield on the student loans does not exceed the yield on the issue by more than two percentage points. In lieu of the amount described in the preceding sentence, the issuer may substitute such larger amount as is necessary to pay expenses (including losses resulting from bad debts) reasonably expected to be incurred as a direct result of administering the student loan program to the extent that those expenses are not payable with funds appropriated from other sources.

(ii) *Administrative costs.* For purposes of determining the yield on student loans under paragraph (b)(1)(i) of this section, administrative costs (within the meaning of §1.103-13(c)(5)(iv)(A) and (B)) that are paid by the obligors are not taken into account. The preceding sentence applies whether or not the payments are made from proceeds of the issue and whether or not the payments are treated as reimbursements of administrative costs, provided that the present value of the payments does not exceed the present value of the administrative costs paid by the issuer. This paragraph (b)(1)(ii) does not apply to any amount taken into account in computing the yield on the issue.

(2) *Special allowance payments.* Payments made by the Secretary of Education pursuant to section 438 of the Higher Education Act of 1965 are taken into account in determining the yield on student loans.

(3) *Effective date.* This paragraph (b) applies to any bond issued after January 5, 1990, except—

(i) A bond issued exclusively to refund a bond issued before that date if—

(A) The amount of the refunding bond does not exceed 101 percent of the amount of the refunded bond; and

(B) The maturity date of the refunding bond is not later than the date that is 17 years after the date on which the refunded bond was issued (or, in the case of a series of refundings, the date on which the original bond was issued); and

(ii) A qualified student loan bond described in section 144(b)(1)(A) needed to fulfill binding written commitments to acquire or finance student loans originated before such date and after June 30, 1984, but only if the amount of those commitments is consistent with practices of the issuer that were in effect on March 15, 1984, with respect to establishing secondary markets for student loans described in section 144(b)(1)(A).

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 22, 1990, 2:36 p.m., and published in the issue of the Federal Register for January 25, 1990, 55 F.R. 2511 as corrected by 55 F.R. 4998)

26 CFR 1.148-10T: Special rules for qualified student loan bond purpose investments (temporary).

T.D. 8285

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Yield Adjustment Payments for Qualified Student Loan Bonds

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to certain yield adjustment payments to be made with respect to excess earnings on acquired purpose obligations acquired with proceeds of qualified student loan bonds. Changes to the applicable law were made by the Tax Reform Act of 1984 and the Tax Reform Act of 1986. The text of the temporary regulations set forth in this document also serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in *** [FI-75-89, page 631, this Bulletin].

EFFECTIVE DATE: These temporary regulations are effective for qualified student loan bonds issued after January 5, 1990.

SUPPLEMENTARY INFORMATION:

Background

On July 5, 1989, proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 148 of the Internal Revenue Code, relating to arbitrage bonds, were published in the *Federal Register* (54 FR 28075) [FI-80-86, 1989-2 C.B. 817]. Section 1.148-10(b)(2)(ii) of the proposed regulations states that the Commissioner shall adopt procedures under which issuers of qualified student loan bonds described in section 144(b)(1)-(A) may "rebate" to the United States amounts necessary to reduce the yield on student loans to a yield that is not materially higher than the yield on the issue. A public hearing with respect to the proposed regulations was held on December 13, 1989. Most of the provisions of the proposed regulations are being adopted in T.D. 8284 in *** [FI-75-89, page 631, this Bulletin].

Numerous commentators at the public hearing as well as those submitting written comments regarding the proposed regulations have expressed concern that the absence of guidance regarding the implementation of the "rebate" procedure described in §1.148-10(b)(2)(ii) was a significant problem. These temporary regulations provide guidance regarding the "rebate" procedure referred to in §1.148-10(b)(2)(ii) of the proposed regulations. Because of the possibility of confusion with the "rebate" referred to in section 148(f), the "rebate" payment referred to in §1.148-10(b)(2)(ii) of the proposed regulations is renamed a "yield adjustment payment" in these temporary regulations.

Explanation of Provisions

Issuers of qualified student loan bonds must restrict the yield to maturity (yield) on acquired purpose obligations (student loan notes) acquired with proceeds of the bonds to a yield that is not materially higher than the yield on the bonds. Because of factors such as variable administrative costs and variable special assistance payments (SAP), the yield on the student loan notes may be materially higher than the yield on the bond issue. Under the temporary regulations, qualified student loan bonds that would be arbitrage bonds solely because the yield on student loan notes acquired with proceeds of the bonds is materially higher than the yield on the bond issue are not arbitrage bonds if the issuer makes yield adjustment payments to the United States based on the amount of excess earnings on the student loan notes. Excess earnings on student loan notes are that portion of the total earnings taken into account in determining the yield on the notes which results in the notes having a materially higher yield than the bond issue.

The payment of yield adjustment payments to the United States does not prevent a qualified student loan bond from being an arbitrage bond if proceeds of the bond not invested in student loan notes are invested in a manner that would cause the bonds to be arbitrage bonds under section 148. The temporary regulations apply only to student loan notes.

Generally, the temporary regulations require the issuer to calculate excess earnings on or before the tenth anniversary of the date of issue of the bond issue and every five years thereafter (the excess earnings calculation date). The temporary regulations also require that excess earnings be calculated on the date the last bond that is part of an issue matures or is redeemed. Yield adjustment payments are based on excess earnings and are due on or before the date that is 60 days after the excess earnings calculation date.

A problem may arise in calculating excess earnings and making yield adjustment payments prior to the final maturity or redemption of a bond issue because the issuer may not yet know of all the amounts that will eventually be taken into account in computing the yield on either the bonds or the student loan notes. Servicing fees and other costs of administering a student loan program tend to be relatively constant over the life of a student loan while interest earnings and SAP with respect to a student loan generally decline over the life of the loan. Therefore, computation of the yield on a student loan note prior to the date it matures or is redeemed may result in a higher yield (and therefore a higher excess earnings amount) than would be computed at maturity. Most student loan notes mature or are repaid within 7 years of the date repayment of the loan begins (usually 8 to 11 years after the loan is made). The temporary regulations generally do not require an excess earnings calculation and a corresponding yield adjustment payment until 10 years after the date of issue of the bonds. Also, the temporary regulations generally require that only 50 percent of excess earnings be paid in the first yield adjustment payment (60 days after the tenth anniversary) and only 75 percent of excess earnings be paid in subsequent yield adjustment payments prior to maturity or redemption of the bonds. One hundred percent of excess earnings is due upon maturity or redemption of the last bond that is part of the issue.

Requiring less than 100 percent of excess earnings to be paid in yield adjustment payments other than at maturity or redemption provides a "cushion" in the event that subse-

quent earnings and expenses allocable to the notes cause a previously computed yield to be too high. This "cushion" should also significantly reduce any possibility of an overpayment of excess earnings to the United States.

The Service welcomes comments regarding the computation of excess earnings, the yield adjustment payment amount, and yield adjustment payment intervals.

Effective Date

These temporary regulations apply to qualified student loan bonds issued after January 5, 1990.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Part 1 is amended as follows:

PART 1—[AMENDED]

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. *** Section 1.148-10T also issued under 26 U.S.C. 148(g) and (i) and 98 Stat. 924.

Par. 2. The following new section 1.148-10T is added in the appropriate place:

§1.148-10T Special rules for qualified student loan bond purpose investments (Temporary).

(a) *Yield adjustment payment of excess earnings to the United States*—(1) *Effect of yield adjustment payments.* If an issuer of qualified student loan bonds, at the time and in the manner prescribed in paragraph (d) of this section, remits to the United States yield adjustment payments as described in paragraph (e) of this section, then, for purposes of determining whether the bonds are arbitrage bonds, the yield of the class of acquired purpose obligations (student loan notes) that were acquired with the proceeds of the bonds is deemed to be not materially higher than the yield on the bond issue. For purposes of computing the yield under section 148 on the class of acquired purpose obligations, yield adjustment payments that are so remitted are treated as reductions in the earnings of the class of obligations.

(2) *Scope of section.* This section applies only to qualified student loan bonds and to acquired purpose obligations of a qualified student loan bond issue that are eligible to be treated as acquired program obligations under §1.103-13(h)

(b) *Excess earnings defined*—(1) *In general.* As of any excess earnings calculation date (defined in paragraph (c) of this section), the excess earnings of the class of acquired purpose obligations is the smallest amount that, if treated as reasonable costs (taken into account in calculating yield) paid on that date, would reduce the yield on the class to a yield that is not materially higher than the yield on the bonds. See §§1.103-13(b)(5)-(viii), 1.103-13(b)(5)(ix), and 1.148-10(b)(1).

(2) *Yield defined.* For purposes of this paragraph (b), as of any excess earnings calculation date, the yield on the class of acquired purpose obligations and the yield on qualified student loan bonds is computed in the manner set forth in §1.103-13(c) with the following modifications—

(i) The calculation of excess earnings is cumulative, and each prior yield adjustment payment is taken into account (as of the excess earnings calculation date with respect to which the payment was calculated) as a reduction in the earnings on the class of acquired purpose obligations;

(ii) Obligations acquired after the excess earnings calculation date are not taken into account in determining the yield on the obligations;

(iii) Acquired purpose obligations held on the excess earnings calculation date are treated as if liquidated on that date at their stated redemption price at maturity plus unpaid accrued interest as of the excess earnings calculation date;

(iv) If the issue price of a bond was at least 98 percent of its stated redemption price at maturity and the bond is outstanding as of the excess earnings calculation date—

(A) All interest and principal payments due with respect to the bond between the excess earnings calculation date and the deemed redemption date are treated as paid as of the dates due, and

(B) The bond is treated as redeemed as of the deemed redemption date at an amount equal to the stated redemption price of the bond at maturity plus interest (other than original issue discount, if any) scheduled to be accrued and unpaid as of the deemed redemption date less any payments of principal paid on or before the excess earnings calculation date and less any payments of principal described in paragraph (b)(2)(iv)(A) of this section;

(v) If the issue price of a bond was less than 98 percent of its stated redemption price at maturity and the bond is outstanding as of an excess earnings calculation date—

(A) All interest and principal payments due with respect to the bond between the excess earnings calculation date and the deemed redemption date are treated as paid as of the dates due, and

(B) The bond is treated as redeemed as of the deemed redemption date at an amount equal to the issue price plus interest (including original issue discount) scheduled to be accrued and unpaid as of the deemed redemption date less any payments of principal paid on or before the excess earnings calculation date and less principal payments described in paragraph (b)(2)(v)(A) of this section; and

(vi) The accrual of original issue discount is determined in the manner provided by section 1272(a).

(c) *Excess earnings calculation date defined*—(1) *First earnings calculation date.* The first excess earnings calculation date with respect to an issue is a date chosen by the issuer that is not later than the earlier of—

(i) The date the last bond that is

part of the issue matures or is redeemed, or

(ii) The tenth anniversary of the date of issue of the bond issue.

(2) *Subsequent excess earnings calculation dates.* Subsequent to the first excess earnings calculation date, each excess earnings calculation date is the earlier of—

(i) The date that is 5 years after the immediately preceding excess earnings calculation date, or

(ii) The date the last bond that is part of the issue matures or is redeemed.

(d) *Time and manner of making yield payments.* Yield adjustment payments must be made—

(1) Within 60 days of each excess earnings calculation date, and

(2) In accordance with procedures published by the Internal Revenue Service.

(e) *Yield adjustment payment defined*—(1) *Last payment.* The yield adjustment payment (if any) for the last excess earnings calculation date is an amount chosen by the issuer that is not less than 100 percent of the excess earnings calculated as of that date.

(2) *Special rules for first excess earnings calculation date.* If the first excess earnings calculation date with respect to an issue is not the last excess earnings calculation date for the issue, then the amount of the yield adjustment payment (if any) with respect to that date is an amount chosen by the issuer that is not less than 50 percent of the excess earnings calculated as of that date.

(3) *Special rule for subsequent excess earnings calculation dates where bonds are outstanding.* If an excess earnings calculation date is neither the first nor the last excess earnings calculation date for an issue, the amount of the yield adjustment payment (if any) with respect to that date is an amount chosen by the issuer that is not less than 75 percent of the excess earnings calculated for that date.

(f) *Definitions*—(1) *Acquired purpose obligation.* The term "acquired purpose obligation" is defined in §1.103-13(b)(4)(iv)(A).

(2) *Arbitrage bond.* The term "arbitrage bond" means a bond described in section 148(a).

(3) *Deemed redemption date.* For any excess earnings calculation date for a bond, the term "deemed redemption date" means the earlier of—

(i) The maturity date of the bond, or

(ii) The first date, if any, which is after the excess earnings calculation date and on which the rate of interest borne by the bond may change to a rate not determinable prior to the excess earnings calculation date.

(4) *Issue price.* The term "issue price" means the issue price calculated under sections 1273 and 1274.

(5) *Materially higher.* The term "materially higher" is defined in §1.148-10(b)(1)(i) with respect to acquired purpose obligations that the issuer elects to treat as acquired program obligations within the meaning of §1.103-13(b)(5)(i) and is defined in §1.103-13(b)(5) with respect to all other acquired purpose obligations.

(6) *Original issue discount.* The term "original issue discount" is defined in section 1273(a)(1).

(7) *Qualified student loan bond.* The term "qualified student loan bond" is defined in section 144(b)(1)(A).

(8) *Stated redemption price at maturity.* The term "stated redemption price at maturity" is defined in section 1273(a)(2).

(g) *Effective date.* This section applies to any qualified student loan bond issued after January 5, 1990.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved January 16, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 22, 1990, 2:36 p.m., and published in the issue of the Federal Register for January 25, 1990, 55 F.R. 2512)

Subpart C.—Definitions and Special Rules

Section 150.—Definitions and Special Rules

Section 4.01(5) of Rev. Proc. 90-3, page 402, this Bulletin, relating to areas under former section 103(b) of the Code for which rulings will not ordinarily be issued by the Service, is modified to reflect changes resulting from the enactment of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 519. See Rev. Proc. 90-35, page 555.

Part V.—Deductions for Personal Exemptions

Section 151.—Allowance of Deductions for Personal Exemptions

26 CFR 1.151-4: Amount of deduction for each exemption under section 151.

The Service is providing inflation adjustments to the personal exemption for taxable years beginning in 1990. See Rev. Proc. 90-7, page 432.

Part VI.—Itemized Deductions for Individuals and Corporations

Section 162.—Trade or Business Expenses

26 CFR 1.162-2: Traveling expenses. (Also Sections 62, 262, 274; 1.62-2T, 1.262-1, 1.274-5T.)

Rev. Rul. 190 distinguished. This revenue ruling allows a taxpayer with one or more regular places of business a business expense deduction for transportation expenses paid or incurred by the taxpayer in going between the taxpayer's residence and a temporary work location, regardless of the distance traveled. Rev. Rul. 190 distinguished; Rev. Rul. 55-109 modified; Rev. Rul. 59-371 distinguishable.

Rev. Rul. 90-23

ISSUES

For a taxpayer with one or more regular places of business:

(1) Are daily transportation expenses paid or incurred by the taxpayer in going between the taxpayer's residence and a temporary work location of the taxpayer deductible business expenses under section 162(a) of the Internal Revenue Code?

(2) Are amounts paid as a reimbursement or other expense allowance for such daily transportation expenses

excludable from the employee's gross income pursuant to section 62(a)(2)-(A) of the Code and section 1.62-2T of the temporary Income Tax Regulations?

(3) Is an employer required to report on an employee's Form W-2, or to withhold and pay employment taxes on, amounts paid as a reimbursement or other expense allowance for such daily transportation expenses?

LAW AND ANALYSIS

Issue (1)

Section 162 of the Code allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under this provision, a taxpayer may deduct the daily transportation expenses paid or incurred in the taxpayer's trade or business.

Section 262 of the Code, however, provides that no deduction is allowed for personal, living, or family expenses. Commuting expenses are specifically treated as nondeductible personal expenses under sections 1.162-2(e) and 1.262-1(b)(5) of the Income Tax Regulations.

Section 67(a) of the Code provides that miscellaneous itemized deductions for any taxable year may be deducted only to the extent that the aggregate amount of such deductions exceeds 2 percent of adjusted gross income under section 62. Section 67(b) provides that the term "miscellaneous itemized deductions" means itemized deductions other than those specifically listed therein. A business expense deduction under section 162(a) is a miscellaneous itemized deduction because it is not one of the deductions specifically listed in section 62(b).

Daily transportation expenses paid or incurred by a taxpayer in going between the taxpayer's residence and one or more regular places of business or employment are nondeductible personal commuting expenses under section 262 of the Code. However, daily transportation expenses paid or incurred by a taxpayer in going between two specific business locations (whether in the same business or different businesses) are deductible business expenses. *See* Rev. Rul. 55-109, 1955-1 C.B. 261.

Rev. Rul. 190, 1953-2 C.B. 303, provides a limited exception to the general rule of commuting expense nondeductibility. It holds that, for a taxpayer who ordinarily works in a particular metropolitan area but who is not regularly employed at any specific work location, daily transportation expenses are deductible business expenses when paid or incurred by the taxpayer in going between the taxpayer's residence and a temporary work site *outside* that metropolitan area. However, such expenses are not deductible when paid or incurred in going between the taxpayer's residence and a temporary work site *within* such metropolitan area because that area is considered the taxpayer's regular place of business.

A taxpayer who pays or incurs daily transportation expenses on trips between the taxpayer's residence and one or more regular places of business is like the taxpayer described in Rev. Rul. 190 who pays or incurs daily transportation expenses on trips between the taxpayer's residence and temporary work sites *within* the metropolitan area that is considered the taxpayer's regular place of business. Such daily transportation expenses are nondeductible commuting expenses. On the other hand, a taxpayer who has one or more regular places of business and who pays or incurs daily transportation expenses for trips between the taxpayer's residence and temporary work locations is like the taxpayer described in Rev. Rul. 190 who pays or incurs deductible daily transportation expenses for trips between the taxpayer's residence and temporary work sites *outside* the metropolitan area that is considered the taxpayer's regular place of business. Thus, for a taxpayer who has one or more regular places of business, daily transportation expenses paid or incurred in going between the taxpayer's residence and temporary work locations are deductible business expenses under section 162(a) of the Code regardless of the distance.

For purposes of determining whether daily transportation expenses within the metropolitan area are deductible business expenses or nondeductible commuting expenses, a regular place of business is any location at which the taxpayer works or performs services on a regular basis, and a temporary place of business is any location at which the taxpayer performs services on an irregular or short-term (*i.e.*, generally a matter of days or weeks) basis. A taxpayer may be considered as working or performing services at a particular location on a regular basis whether or not the taxpayer works or performs services at that location every week or on a set schedule. Thus, for example, daily transportation expenses incurred by a doctor in going between the doctor's residence and one or more offices, clinics, or hospitals at which the doctor works or performs services on a regular basis are nondeductible commuting expenses. However, daily transportation expenses incurred by the doctor in going between a clinic and a hospital or between the doctor's residence and a temporary work location are deductible business expenses.

If it is determined upon examination that there is a clear pattern of abuse by the taxpayer in claiming a business expense deduction for daily transportation expenses paid or incurred in going between the taxpayer's residence and asserted temporary work locations without proof of a valid business purpose, the Service will disallow any deduction for such expenses and impose appropriate penalties.

Issues (2) and (3)

For purposes of determining "adjusted gross income," section 62(a)(2)(A) of the Code allows an employee a deduction from gross income for expenses allowed by Part VI (section 161 and following), subchapter B, chapter 1 of the Code, paid by an employee, in connection with the performance of services as an employee, under a reimbursement or other expense allowance arrangement with a payor (the employer, its agent, or a third party).

Section 62(c) of the Code provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of section 62(a)(2)(A) if (1) such arrangement does not require the employee to substantiate the expenses covered by the arrangement to the payor, or (2) such arrangement provides the employee the right to retain any amount in excess of the

substantiated expenses covered under the arrangement.

Under section 1.62-2T(c)(1) of the temporary regulations, a reimbursement or other expense allowance arrangement satisfies the requirements of section 62(c) of the Code if it meets the requirements of business connection, substantiation, and returning amounts in excess of expenses as specified in the regulations. If an arrangement meets these requirements, all amounts paid under the arrangement are treated as paid under an "accountable plan," except that any amounts retained in excess of the amounts substantiated are treated as paid under a "nonaccountable plan." *See* section 1.62-2T(c)(2) and (c)(3)(ii). If an arrangement does not satisfy one or more of these requirements, all amounts paid under the arrangement are treated as paid under a "nonaccountable plan." *See* section 1.62-2T(c)(3).

Section 1.62-2T(c)(4) of the temporary regulations provides that amounts treated as paid under an accountable plan are excluded from the employee's gross income, are not required to be reported on the employee's Form W-2, and are exempt from the withholding and payment of employment taxes (FICA, FUTA, RRTA, RUTA, and income tax). Section 1.62-2T(c)(5) provides that amounts treated as paid under a nonaccountable plan are included in the employee's gross income, must be reported to the employee, and are subject to withholding and payment of employment taxes. For withholding and payment of employment tax requirements, see sections 31.3121(a)-2T, 31.3231(e)-3T, 31.3306(b)-2T, and 31.3401(a)-2T of the Employment Tax Regulations, which apply to payments made under reimbursement or other expense allowance arrangements received by an employee on or after July 1, 1990, with respect to expenses paid or incurred on or after July 1, 1990. For reporting requirements, see section 1.6041-3(i), which generally applies to payments made under reimbursement or other expense allowance arrangements received by an employee on or after January 1, 1989, with respect to expenses paid or incurred on or after January 1, 1989.

Consistent with the position in this revenue ruling on Issue (1) providing for the deductibility of daily transportation expenses paid or incurred by a taxpayer with one or more regular places of business in going between the taxpayer's residence and a temporary work location, an employee is not required to include in gross income the portion of a reimbursement or other expense allowance for such daily transportation expenses that is treated as paid under an accountable plan pursuant to section 1.62-2T(c)(2) and (c)(4) of the temporary regulations. In addition, such portion of the reimbursement or allowance is not required to be reported on the employee's Form W-2 and is exempt from the withholding and payment of employment taxes. For purposes of meeting the accountable plan requirements, an employee may use any of the Service-specified deemed substantiation procedures (e.g., the business standard mileage rate) to substantiate the amount of the daily transportation expenses paid or incurred. See Rev. Proc. 89-66, 1989-2 C.B. 792.

An employee is required to include in gross income only the portion of a reimbursement or other expense allowance for such daily transportation expenses that is treated as paid under a nonaccountable plan pursuant to section 1.62-2T(c)(3) and (c)(5) of the temporary regulations. In addition, the excess portion of the reimbursement or allowance is required to be reported on the employee's Form W-2 and is subject to withholding and payment of employment taxes.

HOLDINGS

For a taxpayer with one or more regular places of business:

(1) Daily transportation expenses paid or incurred by the taxpayer in going between the taxpayer's residence and a temporary work location of the taxpayer are deductible business expenses under section 162(a) of the Code.

If the taxpayer is an employee, the taxpayer may deduct such daily transportation expenses only as a miscellaneous itemized deduction subject to the 2-percent floor provided in section 67 of the Code. However, see Holding (2) below for the treatment of those expenses reimbursed under an accountable plan.

(2) An employee is not required to include in gross income the portion of amounts paid as a reimbursement or other expense allowance for such daily transportation expenses that is treated as paid under an accountable plan pursuant to section 1.62-2T(c)(2) and (c)(4). An employee is required to include in gross income the portion of amounts paid as a reimbursement or other expense allowance for such daily transportation expenses that is treated as paid under a nonaccountable plan pursuant to section 1.62-2T(c)(3) and (5). The employee may claim a miscellaneous itemized deduction for the amount by which the deductible daily transportation expenses exceed the portion of the amounts paid as a reimbursement or other expense allowance for such expenses that is treated as paid under an accountable plan, but such deduction is subject to the 2-percent floor provided in section 67 of the Code.

(3) An employer is not required to report on the employee's Form W-2, or to withhold and pay employment taxes on, the portion of amounts paid as a reimbursement or other expense allowance for such daily transportation expenses that is treated as paid under an accountable plan pursuant to section 1.62-2T(c)(2) and (c)(4). An employer is required to report on the employee's Form W-2, and to withhold and pay employment taxes on, the portion of amounts paid as a reimbursement or other expense allowance for such daily transportation expenses that is treated as paid under a nonaccountable plan pursuant to section 1.62-2T(c)(3) and (5).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 190 is distinguished because the employees in that revenue ruling were not regularly employed at any specific work location. The federal income tax treatment of taxpayers within the scope of Rev. Rul. 190 (*i.e.*, those who are not regularly employed at any specific work location and who travel to temporary jobs outside the metropolitan area) remains unchanged.

Rev. Rul. 59-371, 1959-2 C.B. 236, which in part sets forth rules concerning what is "temporary" employment for purposes of Rev. Rul. 190, is distinguishable.

Rev. Rul. 55-109, which in part provides for the deductibility of daily

transportation expenses paid or incurred by a taxpayer who is a member of an Armed Forces reserve unit in going between the taxpayer's residence and the regular meetings of the reserve unit that are held at a location outside the metropolitan area in which the taxpayer is regularly employed, is hereby modified to provide for the nondeductibility of such expenses paid or incurred on or after January 1, 1990.

Rev. Rul. 55-109 also states that the regular place of business of a taxpayer is not limited to the office or building at which the taxpayer regularly works or performs services but includes the entire metropolitan area in which such site is located. Rev. Rul. 55-109 is hereby further modified by deleting such statement.

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26 CFR 1.162-17: Reporting and substantiation of certain business expenses of employees.

Self-employed individuals and employees may use the federal meal and incidental expense rate to compute the amount allowable as a deduction for business meal and incidental expenses paid or incurred while traveling away from home. See Rev. Proc. 90-15, page 476.

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26 CFR 1.162-17: Reporting and substantiation of certain business expenses of employees.

The revenue procedure provides rules under which the amount of ordinary and necessary expenses paid or incurred by an employee in driving an automobile in connection with the performance of services as an employee of the employer will be deemed substantiated under section 1.274-5T of the temporary regulations when a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. See Rev. Proc. 90-34, page 552.

Section 163.—Interest

Guidelines are set forth regarding the disallowance, under section 265(b) of the Code, of interest expense allocable to tax-exempt obligations held by financial institutions. See Rev. Rul. 90-44, page 54.

26 CFR 1.163-1: Interest deduction in general.

The terms of the described issue of dutch-auction rate preferred stock do not prevent the corporation receiving a dividend distribution with respect to the stock from claiming the dividend received deduction. See Rev. Rul. 90-27, page 50.

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26 CFR 1.163-5: Denial of interest deduction on certain obligations issued after December 31, 1982, unless issued in registered form.

T.D. 8300

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 35a, 46, and 602

Registration Requirements with Respect to Certain Debt Obligations; Application of Repeal of 30 Percent Withholding by the Tax Reform Act of 1984

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final Income Tax Regulations relating to the definition of the term "registration required obligations" with respect to obligations issued to certain foreign persons and relating to the imposition of sanctions on issuers of registration required obligations in bearer form. This document also contains temporary regulations relating to the repeal of 30 percent withholding on certain types of interest by the Tax Reform Act of 1984. These regulations provide the public with guidance necessary to comply with the Tax Equity and Fiscal Responsibility Act of 1982 and the Tax Reform Act of 1984 and affect persons issuing debt obligations to foreign persons.

EFFECTIVE DATE: These regulations are effective May 10, 1990. The text of the regulations states the dates of applicability of the rules contained therein to various transactions and taxpayers.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. §3504(h)) under control number 1545-1132. The annual burden per respondent or recordkeeper is estimated to be 10 minutes.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on information as is available to the Internal Revenue Service. Individual respondents or recordkeepers may require greater or less time, depending on their particular circumstances.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the Internal Revenue Service, Attention: IRS Reports Clearance Officer, T:FP, Washington, DC 20224, and to the Office of Management and Budget, Paperwork Reduction Project (1545-1132), Washington, DC 20503.

Background

On August 24, 1989, the FEDERAL REGISTER published proposed amendments (54 FR 35200) [INTL-0536-89, 1989-2 C.B. 833] to the Income Tax Regulations (26 CFR Part 1 and 46) under sections 163(f), 871, 881, 1441, 1442 and 4701 of the Internal Revenue Code of 1986. Section 1.163-5(c) of the regulations incorporated by reference certain requirements based on the interpretation of the Securities Act of 1933 by the Securities and Exchange Commission (SEC). The SEC proposed to revise its interpretation of that Act. The proposed amendments were in response to that action. Written comments responding to this notice were received. No public hearing was requested and no public hearing was held. After consideration of all comments regarding the proposed amendments, those amendments are adopted by this Treasury Decision with revisions in response to those comments. The comments and revisions are discussed below.

Explanation of Provisions

The proposed regulations under §1.163-5(c)(2)(i) provided rules relating to whether an obligation would be considered to be issued under arrangements reasonably designed to insure that the obligation will be sold (or resold in connection with its original issuance) only to a person who is not a United States person. Obligations that satisfied the "arrangements reasonably designed" test under §1.163-5(c)(2)(i)(A) or (B) were required, after the effective date, to satisfy new §1.163-5(c)(2)(i)(D).

Proposed §1.163-5(c)(2)(i)(D) listed seven requirements. In brief they were:

(1) Neither the issuer nor any distributor makes a directed selling effort with respect to the obligation;

(2) Neither the issuer nor any distributor offers the obligation within the United States or its possessions or to a United States person;

(3) The issuer does not, and each distributor covenants that it will not, sell the obligation within the United States or its possessions or to a U.S. person during the restricted period;

(4) Neither the issuer nor any distributor delivers the obligation within the United States or its possessions during the restricted period;

(5) All offering materials and documents used in connection with the original issuance of the obligation include a statement that the obligation may not be offered or sold within the United States or its possessions or to a United States person;

(6) If the issuer or any distributor sells the obligation during the restricted period to a distributor, a dealer, or any other person who receives a selling concession, fee or other remuneration in respect to the security sold, the seller sends a confirmation to such person stating that such person is subject to the restrictions regarding offer, sale, and delivery of the obligation during the restricted period; and

(7) No later than the 10th day after the last day of the restricted period, a certificate is provided to the issuer or a distributor of the obligation stating that the owner of the obligation on the last day of the restricted period is not a United States person.

The term "distributor" was defined to mean any affiliate of the issuer, the lead underwriter, any person participating in the original issuance of the obligation pursuant to a contractual arrangement, and any person acting on behalf of the issuer or any of the foregoing.

The term "restricted period" was defined as the forty day period beginning on the later of the closing of the offering or the first date on which the obligation is offered to persons other than a distributor.

Section 1.163-5(c)(2)(i)(D) was proposed to be applicable to obligations originally issued after the date 30 days after final regulations are published in the FEDERAL REGISTER.

Commentors have suggested a number of difficulties with the proposed regulations under §1.163-5(c)-(2)(i)(D). Principally, those difficulties arise from the possibility that an obligation may fail the requirements of §1.163-5(c)(2)(i)(D) for reasons that may be beyond the control of the issuer, and from the possibility that all the obligations in an issue may fail such requirements if only a few obligations have failed an issue wide requirement. Other comments concerned the lack of an incentive for post-restricted period certifications when delivery of the obligation is not required, and the possibility that the date of applicability of the regulations may not allow sufficient time for amendment of the documentation associated with an issue.

In response to these comments, and in view of the SEC's requirements under Regulation S, these final regulations have deleted the requirements of the proposed regulations relating to directed selling efforts, offering materials and confirmations. The provisions regarding offers and sales have been amended to limit somewhat the issuer's liability for acts of distributors. The certification procedure has been amended so that delivery of an obligation in definitive form triggers certification, and a more delayed effective date of the regulations has been provided.

These final regulations are separate and independent from the rules and interpretations that the SEC chooses to adopt in its administration of the securities laws. The SEC's interpretations will be considered by the Service where appropriate; however, the Service must ultimately base its interpretations on the tax policies underlying section 163(f)(2)(B).

These final regulations contain three requirements: (1) restrictions on offers and sales, (2) restrictions on delivery, and (3) certification.

With respect to offers and sales, the issuer and distributor must not offer or sell the obligation during the restricted period to a person within the United States or its possessions or to a United States person. (The obligation may, however, be sold to a U.S. person in certain circumstances if the person is a financial institution or acquires and holds through a financial institution.) The distributor of the obligation will be deemed to satisfy this requirement if it covenants that it will not offer or sell the obligation during the restricted period to a person who is within the United States or its possessions or to a United States person, and it has in effect, in connection with the offer and sale of the obligation during the restricted period, procedures reasonably designed to insure that its employees or other agents who are directly engaged in selling the obligation are aware that the obligation can not be offered or sold during the restricted period to a person who is within the United States or its possessions or to a United States person.

With respect to delivery of obligations sold during the restricted period, neither the issuer nor any distributor may deliver the obligation in definitive form within the United States or its possessions.

Certification is required on the earlier of the date of the first payment of interest on the obligation or the date of delivery by the issuer of the obligation in definitive form. The certification may be signed or sent either by the owner of the obligation or by a financial institution or clearing organization through which the owner holds the obligation.

The final regulations alter the exception from certification contained in the proposed regulations for "targeted offshore offerings". The changes are in response to comments concerning offers and sales, under the exception, of obligations within or without the targeted foreign country. The IRS will continue to review the use of the exception and may make further changes, if warranted; such changes would be effective on a prospective basis.

The definition of distributor has been amended in these final regulations. A distributor is a person that offers or sells the obligation during the restricted period pursuant to a written contract with the issuer, any person that offers or sells the obligation during the restricted period pursuant to a written contract with a person previously described, and certain affiliates of the issuer or another distributor that offer and sell the obligation during the restricted period.

The preamble to the proposed regulations solicited comments on several issues, including whether registered obligations convertible into bearer form should be treated as registered rather than bearer obligations at the time of issuance. Because of general tax compliance concerns, it has been decided to continue current law, which treats such convertible obligations as being in bearer form at the time of issuance.

These final regulations will apply to obligations originally issued after September 7, 1990. The issuer of an obligation may choose to apply either the rules of §1.163-5(c)(2)(i)(A) or §1.163-5(c)(2)(i)(B), or the rules of these final regulations, to an obligation that is originally issued after May 10, 1990, and on or before September 7, 1990.

This document also publishes temporary regulations revising paragraphs (a), (c) and (e) of §35a.9999-5 and adding new paragraph (e) to §1.163-5T. These temporary regulations amend A-5 of paragraph (a) to provide an exception from the certification requirement for certain short term commercial paper. Under this provision a certificate will not be required under §1.163-5(c)-(2)(i)(D)(*3*) by virtue of A-5 if the obligation is an original issue discount obligation with a maturity of 183 days or less from the date of issuance.

A-18 of paragraph (c) of §35a.9999-5 provides that an obligation that would otherwise be in registered form but for the fact that it is convertible into bearer form is considered to be in bearer form. Under A-1 of §35a.9999-5(a), this provision applies to obligations issued after July 18, 1984. The provision in A-18 is amended in order to better coordinate that provision with §1.163-5(c)-(2)(vi).

A-21 of paragraph (e) of §35a.9999-5 provides that interest paid to the holder of a pass-through certificate described in §1.163-5T(d) may qualify as portfolio interest. It provides further that, for purposes of sections 871(h) and 881(c), interest is considered to be paid on or with respect to the pass-through certificate and not with respect to any obligations held by the fund or trust to which the pass-through certificate relates. This rule was intended to apply with respect to payment from the trustee of the pass-through trust to the certificate holder, but not with respect to payments made to the trustee of the pass-through trust. Thus, the rule applies when the trustee of the pass-through trust is a United States person who collects and pays out interest to the certificate holder, but does not apply when the payment is made to a trustee that is a foreign person. A-21 is amended to clarify this point. A-21 is also amended to clarify its application to REMICs. Section 1.163-5T is also amended to add paragraph (e) concerning REMICs.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulation was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 1, 35a, 46 and 602 are amended as follows:

PART 1—INCOME TAX REGULATIONS

Paragraph 1. The authority for part 1 continues to read in part:

Authority: 26 U.S.C. 7805. * * *

Par. 2. Section 1.163-5(c) is amended as follows:

1. Paragraph (c)(2)(i) introductory text is amended by revising the first, fourth and fifth sentences and by adding a new sentence between the fourth and fifth sentences as set forth below.

2. Paragraph (c)(2)(i)(A) is amended by adding the sentence set forth below after the last sentence thereof.

3. Paragraph (c)(2)(i)(B) introductory text is revised as set forth below.

4. Paragraph (c)(2)(i)(D) is added as set forth below.

5. Paragraph (c)(3) is amended by redesignating the existing text as paragraph (c)(3)(i) and adding a heading at the beginning of newly designated paragraph (c)(3)(i), and by adding a new paragraph (c)(3)(ii) as set forth below.

§1.163-5 Denial of interest deduction on certain 2 obligations issued after December 31, 1982, unless issued in registered form.

* * * * *

(c) *Obligations issued to foreign persons after September 21, 1984—*
* * *

(2) *Rules for the application of this paragraph— (i) Arrangements reasonably designed to ensure sale to non-United States persons.* An obligation will be considered to satisfy paragraph (c)(1)(i) of this section if the conditions of paragraph (c)(2)(i)(A), (B), (C), or (D) of this section are met in connection with the original issuance of the obligation. * * * Obligations that meet the conditions of paragraph (c)(2)(i)(A), (B), (C) or (D) of this section may be issued in a single public offering. The preceding sentence does not apply to certificates of deposit issued under the conditions of paragraph (c)(2)(i)(C) of this section by a United States person or by a controlled foreign corporation within the meaning of section 957(a) that is engaged in the active conduct of a banking business within the meaning of section 954(c)(3)(B) as in effect prior to the Tax Reform Act of 1986, and the regulations thereunder. A temporary global security need not satisfy the conditions of paragraph (c)(2)(i)(A), (B) or (C) of this section, but must satisfy the applicable requirements of paragraph (c)(2)(i)(D) of this section.

(A) * * * Except as provided in paragraph (c)(3) of this section, this paragraph (c)(2)(i)(A) applies only to obligations issued on or before September 7, 1990.

(B) The obligation is registered under the Securities Act of 1933, is exempt from registration by reason of section 3 or section 4 of such Act, or does not qualify as a security under

the Securities Act of 1933; all of the conditions set forth in paragraph (c)(2)(i)(B)(1), (2), (3), (4), and (5) of this section are met with respect to such obligation; and, except as provided in paragraph (c)(3) of this section, the obligation is issued on or before September 7, 1990.

* * * * *

(D) The obligation is issued after September 7, 1990, and all of the conditions set forth in this paragraph (c)(2)(i)(D) are met with respect to such obligation.

(*1*) *Offers and sales — (i) Issuer.* The issuer does not offer or sell the obligation during the restricted period to a person who is within the United States or its possessions or to a United States person.

(*ii*) *Distributors.* (*A*) The distributor of the obligation does not offer or sell the obligation during the restricted period to a person who is within the United States or its possessions or to a United States person.

(*B*) The distributor of the obligation will be deemed to satisfy the requirements of paragraph (c)(2)(i)-(D)(1)(ii)(A) of this section if the distributor of the obligation covenants that it will not offer or sell the obligation during the restricted period to a person who is within the United States or its possessions or to a United States person; and the distributor of the obligation has in effect, in connection with the offer and sale of the obligation during the restricted period, procedures reasonably designed to ensure that its employees or agents who are directly engaged in selling the obligation are aware that the obligation cannot be offered or sold during the restricted period to a person who is within the United States or its possessions or is a United States person.

(*iii*) *Certain rules.* For purposes of paragraph (c)(2)(i)(D)(*1*)(*i*) and (*ii*) of this section:

(*A*) An offer or sale will be considered to be made to a person who is within the United States or its possessions if the offeror or seller of the obligation has an address within the United States or its possessions for the offeree or buyer of the obligation with respect to the offer or sale.

(*B*) An offer or sale of an obligation will not be treated as made to a person within the United States or its possessions or to a United States person if the person to whom the offer or sale is made is: An exempt distributor, as defined in paragraph (c)(2)(i)(D)(*5*) of this section; An international organization as defined in section 7701(a)(18) and the regulations thereunder, or a foreign central bank as defined in section 895 and the regulations thereunder; or The foreign branch of a United States financial institution as described in paragraph (c)(2)(i)(D)(*6*)(*i*) of this section.

Paragraph (c)(2)(i)(D)(*1*)(*iii*)(*B*) regarding an exempt distributor will only apply to an offer to the United States office of an exempt distributor, and paragraph (c)(2)(i)(D)(*1*)(*iii*).

(*B*) regarding an international organization or foreign central bank will only apply to an offer to an international organization or foreign central bank, if such offer is made directly and specifically to the United States office, organization or bank.

(*C*) A sale of an obligation will not be treated as made to a person within the United States or its possessions or to a United States person if the person to whom the sale is made is a person described in paragraph (c)(2)(i)(D)(*6*)(*ii*) of this section.

(*2*) *Delivery.* In connection with the sale of the obligation during the restricted period, neither the issuer nor any distributor delivers the obligation in definitive form within the United States or its possessions.

(*3*) *Certification—(i) In general.* On the earlier of the date of the first actual payment of interest by the issuer on the obligation or the date of delivery by the issuer of the obligation in definitive form, a certificate is provided to the issuer of the obligation stating that on such date:

(*A*) The obligation is owned by a person that is not a United States person;

(*B*) The obligation is owned by a United States person described in paragraph (c)(2)(i)(D)(*6*) of this section; or

(*C*) The obligation is owned by a financial institution for purposes of resale during the restricted period, and such financial institution certifies in addition that it has not acquired the obligation for purposes of resale directly or indirectly to a United States person or to a person within the United States or its possessions. A certificate described in paragraph (c)(2)(i)(D)(*3*)(*i*)(*A*) or (*B*) of this section may not be given with respect to an obligation that is owned by a financial institution for purposes of resale during the restricted period. For purposes of paragraph (c)(2)(i)-(D)(*2*) and (*3*) of this section, a temporary global security (as defined in §1.163-5(c)(1)(ii)(B)) is not considered to be an obligation in definitive form. If the issuer does not make the obligation available for delivery in definitive form within a reasonable period of time after the end of the restricted period, then the obligation shall be treated as not satisfying the requirements of this paragraph (c)(2)(i)-(D)(*3*). The certificate must be signed (or sent, as provided in paragraph (c)(2)(i)(D)(*3*)(*ii*) of this section) either by the owner of the obligation or by a financial institution or clearing organization through which the owner holds the obligation, directly or indirectly. For purposes of this paragraph (c)(2)(i)(D)(*3*), the term "financial institution" means a financial institution described in §1.165-12(c)(i)(v). When a certificate is provided by a clearing organization, the certificate must be based on statements provided to it by its member organizations. The requirement of this paragraph (c)(1)(D)(*3*) shall be deemed not to be satisfied with respect to an obligation if the issuer knows or has reason to know that the certificate with respect to such obligation is false. The certificate must be retained by the issuer (and statements by member organizations must be retained by the clearing organization,in the case of certificates based on such statements) for a period of four calendar years following the year in which the certificate is received.

(*ii*) *Electronic certification.* The certificate required by paragraph (c)(2)(i)(D)(*3*)(*i*) of this section (including a statement provided to a clearing organization by a member organization) may be provided electronically, but only if the person receiving such electronic certificate maintains adequate records, for the retention period described in paragraph (c)(2)(i)(D)(*3*)(*i*) of this section, establishing that such certificate was received in respect of the subject

obligation, and only if there is a written agreement entered into prior to the time of certification (including the written membership rules of a clearing organization) to which the sender and recipient are subject, providing that the electronic certificate shall have the effect of a signed certificate described in paragraph (c)(2)(i)(D)(*3*)(*i*) of this section.

(*iii*) *Exception for certain obligations.* This paragraph (c)(2)(i)(D)(*3*) shall not apply, and no certificate shall be required, in the case of an obligation that is sold during the restricted period and that satisfies all of the following requirements:

(*A*) The interest and principal with respect to the obligation are denominated only in the currency of a single foreign country.

(*B*) The interest and principal with respect to the obligation are payable only within that foreign country (according to rules similar to those set forth in §1.163-5(c)(2)(v)).

(*C*) The obligation is offered and sold in accordance with practices and documentation customary in that foreign country.

(*D*) The distributor covenants to use reasonable efforts to sell the obligation within that foreign country.

(*E*) The obligation is not listed, or the subject of an application for listing, on an exchange located outside that foreign country.

(*F*) The Commissioner has designated that foreign country as a foreign country in which certification under paragraph (c)(2)(i)(D)(*3*)(*i*) of this section is not permissible.

(*G*) The issuance of the obligation is subject to guidelines or restrictions imposed by governmental, banking or securities authorities in that foreign country.

(*H*) More than 80 percent by value of the obligations included in the offering of which the obligation is a part are offered and sold to non-distributors by distributors maintaining an office located in that foreign country. Foreign currency denominated obligations that are convertible into U.S. dollar denominated obligations or that by their terms are linked to the U.S. dollar in a way which effectively converts the obligations to U.S. dollar denominated obligations do not satisfy the requirements of this paragraph (c)(2)(i)(D)(*3*)(*iii*). A foreign currency denominated obligation will not be treated as linked, by its terms, to the U.S. dollar solely because the obligation is the subject of a swap transaction.

(*4*) *Distributor.* For purposes of this paragraph (c)(2)(i)(D), the term "distributor" means:

(*i*) a person that offers or sells the obligation during the restricted period pursuant to a written contract with the issuer;

(*ii*) any person that offers or sells the obligation during the restricted period pursuant to a written contract with a person described in paragraph (c)(2)(i)(D)(4)(i); and

(*iii*) any affiliate that acquires the obligation from another member of its affiliated group for the purpose of offering or selling the obligation during the restricted period, but only if the transferor member of the group is the issuer or a person described in paragraph (c)(2)(i)(D)(*4*)(*i*) or (*ii*) of this section. The terms "affiliate" and "affiliated group" have the same meanings as in section 1504(a) of the Code, but without regard to the exceptions contained in section 1504(b) and substituting "50 percent" for "80 percent" each time it appears. For purposes of this paragraph (c)(2)(i)(D)(*4*), a written contract does not include a confirmation or other notice of the transaction.

(*5*) *Exempt distributor.* For purposes of this paragraph (c)(2)(i)(D), the term "exempt distributor" means a distributor that covenants in its contract with the issuer or with a distributor described in paragraph (c)(2)(i)(*D*)(*4*)(*i*) that it is buying the obligation for the purpose of resale in connection with the original issuance of the obligation, and that if it retains the obligation for its own account, it will only do so in accordance with the requirements of paragraph (c)(2)(i)(D)(*6*) of this section. In the latter case, the covenant will constitute the certificate required under paragraph (c)(2)(i)(D)(*6*). The provisions of paragraph (c)(2)(i)(D)(*7*) governing the restricted period for unsold allotments or subscriptions shall apply to any obligation retained for investment by an exempt distributor.

(*6*) *Certain United States persons.* A person is described in this paragraph (c)(2)(i)(D)(*6*) if the requirements of this paragraph are satisfied and the person is:

(*i*) the foreign branch of a United States financial institution purchasing for its own account or for resale, or

(*ii*) a United States person who acquired the obligation through the foreign branch of a United States financial institution and who, for purposes of the certification required in paragraph (c)(2)(i)(D)(*3*) of this section, holds the obligation through such financial institution on the date of certification.

For purposes of paragraph (c)(2)(i)-(D)(*6*)(*ii*) of this section, a United States person will be considered to acquire and hold an obligation through the foreign branch of a United States financial institution if the United States person has an account with the United States office of a financial institution, and the transaction is executed by a foreign office of that financial institution, or by the foreign office of another financial institution acting on behalf of that financial institution. This paragraph (c)(2)(i)(D)(*6*) will apply, however, only if the United States financial institution (or the United States office of a foreign financial institution) holding the obligation provides a certificate to the issuer or distributor selling the obligation within a reasonable time stating that it agrees to comply with the requirements of section 165(j)(3)(A), (B), or (C) and the regulations thereunder. For purposes of this paragraph (c)(2)(i)(D)(*6*), the term "financial institution" means a financial institution as defined in §1.165-12(c)(1)(v). As an alternative to the certification required above, a financial institution may provide a blanket certificate to the issuer or distributor selling the obligation stating that the financial institution will comply with the requirements of section 165(j)(3)(A), (B) or (C) and the regulations thereunder. A blanket certificate must be received by the issuer or the distributor in the year of the issuance of the obligation or in either of the preceding two calendar years, and must be retained by the issuer or distributor for at least four years after the end of the last calendar year to which it relates.

(*7*) *Restricted period.* For purposes of this paragraph (c)(2)(i)(D), the re-

stricted period with respect to an obligation begins on the earlier of the closing date (or the date on which the issuer receives the loan proceeds, if there is no closing with respect to the obligation), or the first date on which the obligation is offered to persons other than a distributor. The restricted period with respect to an obligation ends on the expiration of the forty day period beginning on the closing date (or the date on which the issuer receives the loan proceeds, if there is no closing with respect to the obligation). Notwithstanding the preceding sentence, any offer or sale of the obligation by the issuer or a distributor shall be deemed to be during the restricted period if the issuer or distributor holds the obligation as part of an unsold allotment or subscription.

(8) *Clearing organization.* For purposes of this paragraph (c)(2)(i)(D), a "clearing organization" is an entity which is in the business of holding obligations for member organizations and transferring obligations among such members by credit or debit to the account of a member without the necessity of physical delivery of the obligation.

* * * * *

(3) *Effective date*—(i) *In general.* * * *

(ii) *Special rules.* If an obligation is originally issued after September 7, 1990, pursuant to the exercise of a warrant or the conversion of a convertible obligation, which warrant or obligation (including conversion privilege) was issued on or before May 10, 1990, then the issuer may choose to apply either the rules of §1.163-5(c)-(2)(i)(A) or §1.163-5(c)-(2)(i)(B), or the rules of §1.163-5(c)(2)(i)(D). The issuer of an obligation may choose to apply either the rules of §1.163-5(c)-(2)(i)(A) or (B), or the rules of §1.163-5(c)(2)(i)(D), to an obligation that is originally issued after May 10, 1990, and on or before September 7, 1990. However, any issuer choosing to apply the rules of §1.163-5(c)-(2)(i)(A) must apply the definition of United States person used for such purposes on December 31, 1989, and must obtain any certificates that would have been required under applicable law on December 31, 1989.

Par. 3. Paragraph (e) of §1.163-5T is added immediately after paragraph (d) of §1.163-5T. Paragraph (e) reads as follows:

§1.163-5T Denial of interest deduction on certain obligations issued after December 31, 1982, unless issued in registered form (temporary).

* * * * *

(e) *Regular interests in REMICS.* (1) A regular interest in a REMIC, as defined in sections 860D and 860G and the regulations thereunder, is considered to be a "registration-required obligation" under section 163(f)(2)(A) and §1.163-5(c) if the regular interest is described in section 163(f)(2)(A) and §1.163-5(c), without regard to whether any obligation held by the REMIC to which the regular interest relates is described in section 163(f)(2)(A) and §1.163-5(c). A regular interest in a REMIC is considered to be described in section 163(f)(2)(B) and §1.163-5(c), if the regular interest is described in section 163(f)(2)(B) and §1.163-5(c), without regard to whether any obligation held by the REMIC to which the regular interest relates is described in section 163(f)(2)(B) and §1.163-5(c).

(2) An obligation held by a REMIC is considered to be described in section 163(f)(2)(A) or (B) if such obligation is described in section 163(f)(2)(A) or (B), respectively, without regard to whether the regular interests in the REMIC are so considered.

(3) For purposes of section 4701, a regular interest is considered to be issued solely by the recipient of the proceeds from the issuance of the regular interest (hereinafter the "sponsor"). The sponsor is therefore liable for any excise tax under section 4701 that may be imposed with reference to the principal amount of the regular interest.

(4) In order to implement the purpose of section 163, §1.163-5(c), and this section, the Commissioner may characterize a regular interest in a REMIC and any obligation held by such REMIC in accordance with the substance of the arrangement they represent and may impose the penalties provided under sections 163(f)(1) and 4701 in the appropriate amounts and on the appropriate persons. This provision may be applied, for example, where a corporation issues an obligation that is purportedly in registered form and that will qualify as a "qualified mortgage" within the meaning of section 860G(a)(3) in the hands of a REMIC, contributes the obligation to a REMIC as its only asset, and arranges for the sale to investors of regular interests in the REMIC in bearer form that do not meet the requirements of section 163(f)(2)(B). If this provision is applied, the obligation held by the REMIC will not be considered to be issued in registered form or to meet the requirements of section 163(f)-(2)(B). The corporation will not be allowed a deduction for the payment of interest on the obligation held by the REMIC, and the excise tax under section 4701, calculated with reference to the principal amount of the obligation held by the REMIC, will be imposed on the corporation and may be collected from the corporation and its agents.

Par. 4. The authority for part 35a continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 5. Section 35a.9999-5 is amended by adding a parenthetical in A-5 (ii) of paragraph (a) immediately before A-5 (iii); by adding a parenthetical in A-5 (iii) of paragraph (a) immediately before A-5 (iv); by removing the first sentence of A-13 of paragraph (b), and adding a new sentence in its place; by adding new subdivision (i)(G) to A-14 of paragraph (b); by removing the sentence immediately before the last sentence of A-18 of paragraph (c), and adding two new sentences in its place; in paragraph (e), by redesignating the text of existing A-21 as subdivision (i) and adding a sentence immediately following the second sentence in newly designated subdivision (i), and adding new subdivision (ii). The added sentences read as follows:

§35a.9999-5 Questions and answers relating to repeal of 30 percent withholding by section 127 of the Tax Reform Act of 1984 and to the application of information reporting and backup withholding in light of such repeal.

* * * * *

(a) *Rules concerning obligations in bearer form.*

* * * * *

A-5. * * * (ii) * * * (determined by reference to the spot rate on the date of issuance, in the case of an obligation not denominated in United States dollars); (iii) * * * (However, an original issue discount obligation with a maturity of 183 days or less from the date of issuance is not required to satisfy the certification requirement of §1.163-5(c)(2)(i)(D)(3).)

* * * * *

(b) *Rules concerning obligations in registered form.*

* * * * *

A-13. An obligation is considered to be targeted to foreign markets for purposes of A-12 if it is sold (or resold in connection with its original issuance) only to foreign persons (or to foreign branches of United States financial institutions described in section 871(h)(4)(B)) in accordance with procedures similar to those prescribed in §1.163-5(c)(2)(i)(A), (B) or (D).

* * * * *

A-14. * * *

(i) * * *

(G) The certificate described in this subdivision may be provided electronically under the terms and conditions of §1.163-5(c)(2)(i)(D)(3)(ii).

* * * * *

(c) *Convertibility of obligations.*

* * * * *

A-18. * * * An obligation issued after July 18, 1984, and on or before September 21, 1984, that would otherwise be in registered form but for the fact that it is convertible into bearer form, shall be considered to be in bearer form for purposes of A-1 if it satisfies the applicable requirements of the relevant temporary or proposed regulations under section 163(f)(2)(B), as described in §1.163-5(c)(2)(vi). An obligation issued after September 21, 1984, that would otherwise be in registered form but for the fact that it is convertible into bearer form shall be considered to be in bearer form. * * *

* * * * *

(e) *Application of repeal of 30 percent withholding to pass-through certificates.*

* * * * *

A-21. (i) * * * The rule of this A-21 applies only to payments made to the holder of the pass-through certificate from the trustee of the pass-through trust and does not apply to payments made to the trustee of the pass-through trust. * * *

(ii) Interest paid to a holder of a regular or residual interest in a REMIC will qualify as portfolio interest under section 871(h)(2) or section 881(c)(2) for purposes of the exemption from 30 percent withholding if the interest paid to the holder satisfies the conditions described in A-1 or A-8 of this section. For purposes of A-1 or A-8 of this section and sections 871(h) and 881(c), interest paid to the holder of a regular interest in a REMIC is considered to be paid on or with respect to the regular interest in the REMIC and not on or with respect to any mortgage obligations held by the REMIC. The foregoing rule, however, applies only to payments made to the holder of the regular interest from the REMIC and does not apply to payments made to the REMIC. For purposes of A-1 or A-8 of this section and sections 871(h) and 881(c), interest paid to the holder of a residual interest in a REMIC is considered to be paid on or with respect to the obligations held by the REMIC, and not on or with respect to the residual interest. For purposes of A-1 and A-8 of this section and section 127 of the Tax Reform Act of 1984, a residual interest in a REMIC will be considered as issued after July 18, 1984, only to the extent that the obligations held by the REMIC are issued after July 18, 1984, but a regular interest in a REMIC will be considered as issued after July 18, 1984, if the regular interest was issued after July 18, 1984, without regard to the date on which the mortgage obligations held by the REMIC were issued.

Par. 6. The authority for Part 46 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 7. Section 46.4701-1 is amended by revising paragraph (b)(5) to read as follows:

§46.4701-1 Tax on issuer of registration-required obligation not in registered form.

* * * * *

(b) *Definitions*—* * *

* * * * *

(5) *Issuer.* Except as provided in §1.163-5T(d) (relating to pass-through certificates) and §1.163-5T(e) (relating to REMICs), the "issuer" is the person whose interest deduction would be disallowed solely by reason of section 163(f)(1).

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 8. The authority for Part 602 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 9. Section 602.101(c) is amended by revising the entry for §1.163-5 in the table to read as follows: "§1.163-5 . . . 1545-1132."

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved April 26, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 4, 1990, 5:00 p.m., and published in the issue of the Federal Register for May 10, 1990, 55 F.R. 19622)

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26 CFR 1.163-11T: Treatment of accrued interest (temporary).

T.D. 8281

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Price Level Adjusted Mortgages

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations concerning the treatment of price level adjusted mortgages under the original issue discount and qualified residence interest provisions of the Internal Revenue Code of 1986. This document also contains a temporary regulation concerning the treatment of payments received under a price level adjusted mortgage for purposes of the information reporting of mortgage interest received from an individual. The regulations are needed to provide guidance to borrowers and lenders concerning the tax treatment of this new financial product. The text of the

temporary regulations set forth in this document also serves as the text of the cross-reference notice of proposed rulemaking published in *** [FI-64-89, page 631, this Bulletin].

EFFECTIVE DATES: Section 1.163-11T is effective for tax years beginning after December 31, 1987. Sections 1.1275-6T and 1.6050H-2T are effective for price level adjusted mortgages issued after January 8, 1990.

SUPPLEMENTARY INFORMATION:

Background

This document contains temporary Income Tax Regulations (26 CFR Part 1) under section 163(h), section 1275(d), and section 6050H of the Internal Revenue Code of 1986. Section 163(h) was enacted by Pub. L. 99-514 (100 Stat. 2246) [1986-3 C.B. (Vol. 1) 1] and amended by Pub. L. 100-647 (102 Stat. 3390). Section 1275(d) was enacted by Pub. L. 98-369 (98 Stat. 543) [1984-3 C.B. (Vol. 1) 1]. Section 6050H was enacted by Pub. L. 98-369 (98 Stat. 684).

Need for Temporary Regulations

Immediate guidance is needed to clarify the tax treatment of price level adjusted mortgages. Therefore, good cause is found to dispense with the notice and public procedure requirements of 5 U.S.C. 553(b) and the delayed effective date requirement of 5 U.S.C. 553(d).

Explanation of HUD Program

In 1983, Congress authorized the Department of Housing and Urban Development ("HUD") to institute a demonstration program for insurance on mortgages that do not provide for fixed interest rates and level payments, including indexed mortgages. The purpose of this program was to develop different types of mortgages that would encourage home ownership by individuals. Under this program, HUD developed a mortgage with a principal balance indexed to inflation, the price level adjusted mortgage ("PLAM"). In general, a PLAM is a mortgage with payments that are designed to be constant in purchasing power instead of dollars. As such, the payments reflect the original amount borrowed, a stated real rate of interest, and inflation over the term of the mortgage.

Under the terms of a PLAM, the outstanding balance is adjusted at monthly intervals for changes in the value of a general price level index, such as the Consumer Price Index, U.S. City Average, All Items, for All Urban Consumers, seasonally unadjusted ("CPI-U"). The monthly payments are also adjusted such that the adjusted payments will amortize the outstanding balance, adjusted for inflation, at the stated rate of interest over the remaining term of the PLAM. Although the outstanding balance is adjusted monthly, the monthly payments on a PLAM may be adjusted at fixed intervals of one month, six months, or one year.

The adjustment to the outstanding balance of a PLAM is determined by multiplying the current outstanding balance by an inflation adjustment, which is the percentage change in the value of the index for a one-month period. Because of the delay in publishing the CPI-U, the one-month period used for this purpose may precede the adjustment by a fixed period of time of up to 4 months.

Because the payments on a PLAM are, in effect, indexed for inflation, the payments will change over the term of the PLAM based on the changes in the value of the inflation index. The payments are approximately constant, however, in terms of purchasing power over the life of the PLAM. In addition, because the interest rate used to amortize a PLAM is a "real" rate of interest, i.e., a rate of interest (typically 3% to 5%) net of anticipated inflation, the initial payments under a PLAM are lower than the initial payments under other types of mortgages, including fixed rate mortgages and adjustable rate mortgages.

HUD has requested guidance from the Department of the Treasury concerning the tax treatment of PLAMs. This document provides such guidance by adding temporary Income Tax Regulations under section 163(h), section 1275(d), and section 6050H of the Code.

Explanation of Provisions

Original Issue Discount

In general, original issue discount arises when the payment of interest that accrues on a debt instrument is deferred beyond the time of accrual. Section 1275(d) grants the Secretary the authority to prescribe regulations that deal with the tax treatment of certain types of debt instruments, including variable rate and contingent payment obligations, under the original issue discount provisions of the Code. Proposed regulations under section 1275(d) were issued on April 8, 1986 (51 FR 12022). Section 1.1275-4 of the proposed regulations prescribes rules for the treatment of debt instruments with contingent payments and §1.1275-5 of the proposed regulations prescribes rules for debt instruments with variable rates of interest.

In form, a PLAM is a debt instrument with a fixed rate of interest and a principal balance that is adjusted monthly for the percentage change in an inflation index. However, a PLAM is also economically equivalent to a debt instrument with a fixed principal balance and a variable rate of interest that changes monthly. In general, the variable rate of interest for any month is equal to the sum of (a) the percentage change in the inflation index ("inflation rate"), (b) the monthly fixed rate of interest stated in the mortgage documents, and (c) the product of the inflation rate and the monthly fixed rate. Because the Service believes that a PLAM should be taxed according to its economic substance, the temporary regulations contained in this document treat a PLAM as a debt instrument with a variable rate of interest for tax purposes. Moreover, because a portion of the amount of interest that accrues on a PLAM is not paid when it accrues, but is added to the outstanding balance, the original issue discount provisions of the Code apply to a PLAM.

The temporary regulations only apply to a debt instrument that is described in §1.1275-6T(b)(1). Under this section of the regulations, a PLAM is defined as a debt instrument that (A) has a fixed term and a stated fixed rate of interest, (B) is issued by an individual in exchange for money, (C) is secured within the meaning of section 163(h)(3) by either (*1*) a mortgage, deed of trust, or other security instrument on 1- to 4-family owner-occupied residential property, or a 1-family owner-

occupied condominium unit, or (2) stock held by the borrower as a tenant-stockholder in a cooperative housing corporation (as defined in section 216), (D) requires periodic payments at intervals of 1 month, (E) provides for monthly adjustments of the outstanding balance of the instrument by an inflation adjustment, and (F) provides for changes in the amount of the periodic payments at intervals of 1 year or less such that the adjusted periodic payments will fully amortize the adjusted outstanding balance of the instrument (as of the beginning of the interval) at the stated fixed rate of interest over the remaining term of the instrument. The temporary regulations also provide that the Commissioner may, by revenue ruling, revenue procedure, or other administrative pronouncement, expand the definition of a PLAM to include other similar debt instruments.

If a debt instrument is a PLAM, as described in §1.1275-6T(b), the instrument is treated as bearing interest at a variable rate that changes monthly. The variable rate of interest for any month is determined under §1.1275-6T(c)(2). Because not all of the interest that accrues on a PLAM is paid currently, a PLAM has original issue discount. Section 1.1275-6T(d)(1) treats the excess of the amount of interest that accrues during a monthly accrual period over any qualified periodic interest payment as original issue discount for the period.

Under §1.1275-6T(d)(2), the amount of interest that accrues during an accrual period is determined by multiplying the outstanding balance of a PLAM at the beginning of an accrual period by the variable interest rate for the accrual period. Any qualified periodic interest payment made during the accrual period, as determined under §1.1275-6T-(d)(4), is then subtracted from this product to determine the amount of original issue discount for the accrual period.

That amount of original issue discount determined under §1.1275-6T-(d)(2) is taken into account by the borrower and the lender (or subsequent holder of the PLAM) under the income inclusion rules under section 1272 and the interest deduction rules under section 163(e). However, in the case of a PLAM incurred in connection with the acquisition or carrying of personal use property, such as a residence, the interest deduction for accrued original issue discount is deferred under section 1275(b)(2) until the original issue discount is paid. Section 1.1275-6T(e)(2) provides rules to determine when original issue discount is considered paid. These rules provide a pro-taxpayer "stacking rule," under which payments are treated first as payments of accrued interest (including original issue discount) and then as payments of principal. Thus, the rules generally will have the effect of allowing a borrower to deduct the full amount of the payments in the early years of the mortgage.

Qualified Residence Interest

Under section 163(h) of the Code, no deduction is allowed for personal interest paid or accrued during the taxable year. Personal interest does not include qualified residence interest. Qualified residence interest is defined as interest that is paid or accrued on acquisition indebtedness with respect to any qualified residence of the taxpayer, or home equity indebtedness with respect to any qualified residence of the taxpayer. Under section 163(h)(3)(B), the term "acquisition indebtedness" generally means any indebtedness that is incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer and is secured by such residence. Under section 163(h)(3)(C), the term "home equity indebtedness" generally means any indebtedness (other than acquisition indebtedness) secured by a qualified residence. In general, acquisition indebtedness may not exceed $1,000,000, and home equity indebtedness may not exceed $100,000.

The regulations contained in this document provide that, for purposes of section 163(h)(3) of the Code, accrued interest is treated as indebtedness until it is paid. In addition, any interest that accrues on acquisition indebtedness is treated as acquisition indebtedness. Therefore, any accrued interest on acquisition indebtedness is subject to the limits on acquisition indebtedness, rather than the limits on home equity indebtedness.

Information Reporting

The regulations contained in this document also clarify the treatment of payments received pursuant to a PLAM for purposes of section 6050H, concerning the information reporting of mortgage interest.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations and, therefore, a final Regulatory Flexibility Analysis is not required.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Part 1 is amended as follows:

PART 1—[AMENDED]

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authorities: 26 U.S.C. 7805 *** Section 1.163-11T is also issued under 26 U.S.C. 163(h) *** Section 1.1275-6T is also issued under 26 U.S.C. 1275(d) *** Section 1.6050H-2T is also issued under 26 U.S.C. 6050H.

Par. 2. A new §1.163-11T is added to read as follows:

§1.163-11T Treatment of accrued interest (Temporary).

(a) *In general.* For purposes of section 163(h)(3), accrued interest is treated as indebtedness until it is paid. For this purpose, interest is treated as accruing at the interval provided in the debt instrument at which such interest compounds, if unpaid.

(b) *Character of interest that accrues on indebtedness incurred to acquire, construct, or substantially improve a residence.* Interest that accrues on indebtedness that is incurred to acquire, construct, or substantially improve a residence of the taxpayer is also treated, until it is paid, as indebtedness incurred to acquire, construct, or substantially im-

prove a residence. Although the amount that may be treated as indebtedness incurred to acquire, construct, or substantially improve a residence is limited to the cost of the residence, accrued interest is not included in the application of this limitation. However, the amount of accrued interest is included in the application of the limitation provided in section 163(h)(3)(B)(ii).

(c) *Refinancing of accrued interest.* Any indebtedness incurred to pay interest that has accrued on indebtedness incurred to acquire, construct, or substantially improve a residence is not treated as indebtedness incurred to acquire, construct, or substantially improve a residence. However, such indebtedness may qualify as home equity indebtedness, subject to the limitations provided in section 163(h)(3)(C).

(d) *Application of this section to price level adjusted mortgages.* (1) *Examples.* The following examples illustrate the application of section 163(h) and this section to price level adjusted mortgages ("PLAMs") described in §1.1275-6T(b)(1).

Example (1). (i) On January 1, 1990, SW, an unmarried individual, purchases her principal residence for $125,000 with a cash down payment of $25,000 and the proceeds of a debt in the amount of $100,000, which is secured by such residence. The debt is a PLAM described in §1.1275-6T(b)(1). Under section 163(h)(3)(B), the amount of acquisition indebtedness with respect to the residence is $100,000 as of January 1, 1990.

(ii) On December 31, 1994, the outstanding balance of the debt is $130,000, of which $30,000 is accrued interest. Under paragraph (b) of this section, as of December 31, 1994, the amount of acquisition indebtedness with respect to the residence is $130,000, notwithstanding that the cost of the residence is only $125,000.

Example (2). (i) On January 1, 1990, DT, an unmarried individual, purchases his principal residence for $950,000, with a cash down payment of $200,000 and the proceeds of a debt in the amount of $750,000, which is secured by such residence. The debt is a PLAM described in §1.1275-6T(b)(1). Under section 163(h)(3)(B), the amount of acquisition indebtedness with respect to the residence is $750,000 as of January 1, 1990.

(ii) On December 31, 1999, the outstanding balance of the debt is $1,150,000, of which $400,000 is accrued interest. Under section 163(h)(3)(B)(ii) and paragraph (b) of this section, the amount of acquisition indebtedness with respect to the residence is limited to $1,000,000. The remainder of the indebtedness may qualify as home equity indebtedness, subject to the limitations contained in section 163(h)(3)(C).

(2) *Cross-reference.* See §1.1275-6T for the rules concerning the amount of interest that accrues on a PLAM and the time when such accrued interest is treated as paid.

(e) *Effective date.* This section is effective for tax years beginning after December 31, 1987.

Par. 3. A new §1.1275-6T is added to read as follows:

§1.1275-6T Treatment of price level adjusted mortgages (Temporary).

(a) *In general.* This section provides general rules for the income tax treatment of a price level adjusted mortgage ("PLAM") that is described in paragraph (b) of this section.

(b) *Description of a PLAM to which this section applies*—(1) *Debt instruments treated as PLAMs*—(i) *In general.* A debt instrument is a PLAM described in this paragraph (b) if it—

(A) Has a fixed term and a stated fixed rate of interest,

(B) Is issued by an individual in exchange for money,

(C) Is secured within the meaning of section 163(h)(3) by a mortgage, deed of trust, or other security instrument on either—

(1) 1- to 4-family owner-occupied residential property, or a 1-family owner-occupied condominium unit, or

(2) stock held by the issuer as a tenant-stockholder in a cooperative housing corporation (as defined in section 216),

(D) Requires periodic payments at intervals of 1 month,

(E) Provides for monthly adjustments of the outstanding balance of the debt instrument by an inflation adjustment, and

(F) Provides for changes in the amount of the periodic payments at intervals of 1 year or less such that the adjusted periodic payments will fully amortize the adjusted outstanding balance of the debt instrument (as of the beginning of the interval) at the stated fixed rate of interest over the remaining term of the debt instrument.

The outstanding balance and periodic payments may be adjusted in a reasonable manner to take into account partial prepayments, advance payments, missed payments, or late payments.

(ii) *Other debt instruments.* Any other debt instrument that is similar to a PLAM described in paragraph (b)(1)(i) of this section will be treated as a PLAM for purposes of this section to the extent provided by the Commissioner in a revenue ruling, revenue procedure, or other administrative pronouncement.

(2) *Inflation adjustment.* For purposes of paragraph(b)(1)(i)(E) of this section, the inflation adjustment for a particular month is the ratio of—

(i) The value of a general price level index for the current month, to

(ii) The value of the same general price level index for the month preceding the current month.

The term "current month" means a month that precedes the beginning of the month for which the inflation adjustment is determined by a fixed period of time that is specified in the instrument and that does not exceed 4 months.

(3) *General price level index.* For purposes of paragraph (b)(2) of this section, the term "general price level index" includes only—

(i) The Consumer Price Index, U.S. City Average, All Items, for all Urban Consumers, seasonally unadjusted ("CPI-U"), which is published by the Bureau of Labor Statistics of the U.S. Labor Department, and

(ii) Any other similar index designated by the Commissioner in a revenue ruling, revenue procedure, or other administrative pronouncement.

(4) *Example.* The provisions of this paragraph (b) may be illustrated by the following example of a PLAM:

Example. (i) On July 1, 1990, *A* borrowed $100,000 to acquire his principal residence. *A*'s obligation is evidenced by a debt instrument and is secured by a mortgage on the residence. The debt instrument has a term of thirty years, has a stated interest rate of 4 percent, requires monthly payments that are due on the first day of every month, provides for monthly adjustments to the outstanding balance for changes in the value of the CPI-U, and provides for adjustment of the amount of the payments on a monthly basis. The inflation adjustment for each month is determined by using a four-month time lag. For example, the inflation adjustment for July 1990 is the ratio of the value of the CPI-U for

March 1990 to the value of the CPI-U for February 1990.

(ii) The first payment on the debt instrument is due on August 1, 1990. The amount of this payment is determined by using the inflation adjustment for July 1990. If there were no change in the CPI-U from February 1990 to March 1990, then the amount of the first payment would be $477.42, which is the monthly payment needed to amortize $100,000 at 4 percent over 360 months. However, if the value of the CPI-U increased during this period, then the first payment would be greater than $477.42 because of the inflation adjustment required under the terms of the debt instrument.

(iii) Assume that the value of the CPI-U for February 1990 is 116.0 and the value of the CPI-U for March 1990 is 116.5. Because the value of the CPI-U increased, the outstanding balance of the debt instrument is increased by the inflation adjustment of 1.0043, which is the ratio of 116.5 to 116.0. As a result, the payment due on August 1, 1990, must be adjusted.

(iv) The first step in calculating the payment due on August 1, 1990, is to multiply the outstanding balance at the beginning of the month ($100,000) by the inflation adjustment of 1.0043. This computation results in an inflation-adjusted balance of $100,430. The second step is to determine the level payment required to amortize this inflation-adjusted balance at the stated interest rate over the remaining term of the debt instrument. Thus, the payment due on August 1, 1990, is $479.47, which is the payment required to amortize $100,430 at 4 percent over 360 months. The outstanding balance of the debt instrument immediately after the first payment is $100,285.26, which is the inflation adjusted balance of $100,430, multiplied by 1.003333 (the sum of 1 plus one twelfth of the fixed interest rate of 4 percent), less the current monthly payment of $479.47.

(v) Assume that the value of the CPI-U for April 1990 is 117.1. The ratio of 117.1 to 116.5 is 1.0052. Thus, 1.0052 is the inflation adjustment for August 1990, which must be applied to the outstanding balance to determine the payment due on September 1, 1990. The adjusted payment is calculated by multiplying the outstanding balance at the beginning of the month ($100,285.26) by 1.0052. This computation results in an inflation-adjusted balance of $100,806.74. Thus, the payment due on September 1, 1990, is $481.96, which is the payment required to amortize $100,806.74 at 4 percent over 359 months. The outstanding balance of the debt instrument immediately after the second payment is $100,660.77, which is the inflation adjusted balance of $100,806.74, multiplied by 1.003333, less the current monthly payment of $481.96.

(vi) Assume that the value of the CPI-U for May 1990 is 118.0. The inflation adjustment is 1.0077. Thus, using the steps described above, the payment due on October 1, 1990, is $485.67, which is the payment required to amortize the inflation-adjusted balance of $101,435.85 at 4 percent over 358 months. The outstanding balance of the debt instrument immediately after the third payment is $101,288.28.

(vii) The payments due for succeeding months are calculated in the same manner.

(viii) In general, because the payments are adjusted monthly, the same monthly payments determined above could have been calculated simply by multiplying the inflation adjustment by the payment due for the preceding month. For example, to determine the payment due on October 1, 1990, multiply the payment due on September 1, 1990 ($481.96) by the inflation adjustment for September 1990 (1.0077). This calculation results in a payment due of $485.67.

(c) *Treatment of a PLAM as a variable rate debt instrument*—(1) *Treatment.* For purposes of subtitle A of the Internal Revenue Code, a PLAM, as described in paragraph (b) of this section, is treated as a debt instrument bearing interest at a variable rate that changes monthly. The variable interest rate of a PLAM is determined under paragraph (c)(2) of this section.

(2) *Variable interest rate.* The variable interest rate on a PLAM for any month is equal to the sum of the percentage change in the general price level index ("inflation rate"), (which is the inflation adjustment defined in paragraph (b)(2) of this section, minus 1), the monthly fixed rate of interest as stated in the mortgage documents, and the product of the inflation rate and the monthly fixed rate. Thus, the variable interest rate on a PLAM for any month may be expressed as follows:

$$INF + R + (INF \times R)$$

where INF is the inflation rate, as defined in the preceding sentence, and R is the PLAM's fixed rate of interest per annum divided by twelve.

(3) *Example.* The provisions of this paragraph (c) may be illustrated by the following example:

Example. The facts are the same as in the example in paragraph (b)(4) of this section. Using the formula described in paragraph (c)(2) of this section, the PLAM bears interest at the following variable rates:

Monthly Accrual Period Ending	*Monthly Variable Rate*
8/01/90	.76473%
9/01/90	.85503%
10/01/90	1.10587%

(d) *Treatment of accrued interest as original issue discount*—(1) *Original issue discount.* For purposes of subtitle A of the Internal Revenue Code, the excess of the amount of interest that accrues on a PLAM over any qualified periodic interest payment as defined in paragraph (d)(4) of this section is original issue discount for the accrual period.

(2) *Amount of accrual.* For purposes of paragraph (d)(1) of this section, the amount of interest that accrues on a PLAM during an accrual period is determined by multiplying the PLAM's outstanding balance at the beginning of the accrual period by the variable interest rate, as determined under paragraph (c)(2) of this section, for the accrual period. Appropriate adjustments are made in the case of short first or final accrual periods.

(3) *Accrual period.* For purposes of paragraph (d) of this section, the accrual period of a PLAM is a month.

(4) *Qualified periodic interest payment.* For purposes of paragraph (d)(1) of this section, the term "qualified periodic interest payment" generally means the portion of each payment that equals the product of the outstanding balance of the PLAM at the beginning of an accrual period and the fixed rate of interest stated in the mortgage documents, provided that the payment is actually and unconditionally payable or is constructively received under section 451 and the regulations thereunder. However, a qualified periodic interest payment cannot exceed the amount of interest that accrues during the accrual period. If payments on a PLAM are not adjusted monthly, the outstanding balance that is used for purposes of determining the qualified periodic interest payment is the outstanding balance at the beginning of the accrual period that coincides with the beginning of the payment adjustment interval.

(5) *Outstanding balance.* For purposes of paragraph (d)(2) and paragraph (d)(4) of this section, the outstanding balance of a PLAM at the beginning of an accrual period is the outstanding balance of the PLAM at the beginning of the prior accrual period, increased by the amount of original issue discount allocable to the prior accrual period and reduced by any payment made during or at the end of the prior accrual period other than a qualified periodic interest payment.

(6) *Determination of daily portion.* For purposes of sections 163(e) and 1272, the daily portion of original issue discount on a PLAM

is an amount equal to the total amount of original issue discount for an accrual period divided by the number of days in the accrual period.

(7) *Example.* The provisions of this paragraph (d) may be illustrated by the following example:

Example. Based on the facts described in the example in paragraph (b)(4) of this section, the original issue discount taken into account by a taxpayer for each monthly accrual period is determined by the calculations shown in the following table:

Monthly Accrual Period Ending	(1) Monthly Variable Rates From(c)(3)	(2) Prior Month's Outstanding Balance (10)	(3) Variable Interest Rate Accruals (1)x(2)	(4) Qualified Periodic Interest Payments (2)x4%/12	(5) Original Issue Discount Accruals (3)-(4)
8/01/90	.76473%	$100,000.00	$ 764.73	$ 333.33	$ 431.40
9/01/90	.85503%	100,285.26	857.47	334.28	523.19
10/01/90	1.10587%	100,660.77	1,113.18	335.54	777.64
Totals			$2,735.38	$1,003.15	$1,732.23

Monthly Accrual Period Ending	(6) Outstanding Balance Before Payment (2)+(3)	(7) Current Debt Service Payment Payment From(b)(4)	(8) Qualified Periodic Interest Payments (4)	(9) Original Issue Discount Payment (7)-(8)	(10) Current Period Outstanding Balance (6)-(7)
8/01/90	$100,764.73	$ 479.47	$ 333.33	$146.14	$100,285.26
9/01/90	101,142.73	481.96	334.28	147.68	100,660.77
10/01/90	101,773.95	485.67	335.54	150.13	101,288.28
Totals		$1,447.10	$1,003.15	$443.95	

On the basis of the preceding calculations, the amount includible in the income of the holder of the PLAM for the three-month period ending October 1, 1990, is $2,735.38.

(e) *Amount deductible by borrower*—(1) *In general.* If section 1275(b)(2) applies to a PLAM, then the original issue discount on the PLAM is not deductible prior to the time when the original issue discount is paid.

(2) *Time when original issue discount treated as paid.* For purposes of paragraph (e)(1) of this section, each payment other than a qualified periodic interest payment as defined in paragraph (d)(4) of this section shall be treated first as a payment of original issue discount to the extent the original issue discount has accrued as of the date of the payment and has not been treated as paid previously, and second as a payment of principal.

(3) *Example.* The provisions of this paragraph (e) may be illustrated by the following example:

Example. The facts are the same as the example in paragraph (d)(7) of this section. In addition, *A* is an individual who uses the cash receipts and disbursements method of accounting. Thus, under section 1275(b)(2) and paragraph (e)(1) of this section, *A*'s interest deduction under section 163 for accrued original issue discount is limited to the lesser of the accrued original issue discount or the amount paid. Thus, for the three-month period ending October 1, 1990, *A*'s deduction under section 163 is limited to $1,447.10 ($479.47 + 481.96 + 485.67), which represents $1,003.15 of qualified periodic interest and $443.95 of accrued original issue discount. *A*'s interest deduction may also be limited by some other provision of the Code or regulations. For example, see section 163(h) and the regulations thereunder.

(f) *Legend.* Under section 1275(c)(1), no information concerning original issue discount is required to be set forth on a PLAM.

(g) *Effective date.* This section is effective for price level adjusted mortgages issued after January 8, 1990.

Par. 4. A new §1.6050H-2T is added to read as follows:

§1.6050H-2T Payments of accrued original issue discount (Temporary).

(a) *Definition of interest.* For purposes of §1.6050H-1 and §1.6050H-2, in the case of a price level adjusted mortgage ("PLAM") described in §1.1275-6T(b)(1), the term "interest" includes payments of accrued original issue discount. The portion of each payment that is treated as a payment of original issue discount is determined under §1.1275-6T.

(b) *Effective date.* This section is effective for price level adjusted mortgages issued after January 8, 1990.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved December 22, 1989.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 8, 1990, 8:45 a.m., and published in the issue of the Federal Register for January 9, 1990, 55 F.R. 729)

Section 165.—Losses

26 CFR 1.165-11: Election in respect of losses attributable to a disaster.

Losses; casualty; disaster areas; year of deduction. Disaster areas in which losses for 1989 qualify for special tax treatment under section 165(i) of the Code are listed.

Rev. Rul. 90-10

LAW AND ANALYSIS-HOLDING

Under section 165(i) of the Internal Revenue Code, if a taxpayer suffers a loss attributable to a disaster occurring in an area subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Disaster Relief and Emergency Assistance Act, Pub. L. No. 100-707, sections 101 thru 113, 102 Stat. 4689 (1988)

(formerly the Disaster Relief Act of 1974, sections 101 and 102, 42 U.S.C. sections 5121 and 5122 (1982), 1974-2 C.B. 414), the taxpayer may elect to take a deduction for that loss on the taxpayer's federal income tax return for the taxable year immediately preceding the taxable year in which the disaster occurred.

The election to deduct for the preceding year must be made on or before the later of (1) the original due date of the taxpayer's income tax return for the year in which the disaster occurred, or (2) the due date of the preceding year's return (taking into account extensions of time for filing granted to the taxpayer). Section 1.165-11 of the Income Tax Regulations. This section of the regulations sets forth the procedures for making an election with respect to such losses.

The provisions of section 165(i) of the Code apply only to losses that are otherwise deductible under section 165(a). An individual taxpayer may deduct losses if they are incurred in a trade or business, if they are incurred in a transaction entered into for profit, or if they are casualty losses under section 165(c)(3).

As of December 29, 1989, the President had determined that the areas listed below have been adversely affected by disasters of sufficient severity occurring during 1989 to warrant disaster assistance by the Federal Government under the Disaster Relief and Emergency Assistance Act.

There may be areas in which a disaster occurred during 1989 and which the President, after December 29, 1989, declares eligible for disaster assistance under the Disaster Relief and Emergency Assistance Act. Information concerning these areas will be published in future issues of the Internal Revenue Bulletin, and these areas will be included in this revenue ruling when it is published in the Cumulative Bulletin.

Disaster Areas in 1989	Type of Disaster	Date Disaster Occurred or Began
Alabama Madison County	Tornadoes and severe storms	November 15, 1989
Alaska Communities of Akiachak, Akhiok, Alakanuk, Allakaket, Anvik, Artic Village, Beaver, Birch Creek, Chevak, Chignik, Eagle Village, Ekwok, Ester, Fort Yukon, Galena, Gamble, Golovin, Grayling, Hyder, Karluk, Kokhanok, Kongiganek, Koyukuk, Levelock, Lime Village, Lower Kalskag, Manokotak, Minto, Mountain Village, New Stuyahok, Nicolai, Sandpoint, Seldovia, Slana, Sleetmute, St. George, St. Michael, Takotna, Tanana, Tattilek, Telida, Tetlin, Thorne Bay, Togiak, Tununak, Venetie, and Whale Pass; and The Northwest Artic Borough	Severe freezing	January 15-February 15, 1989
All political jurisdictions and Alaska native villages along the Yukon and Kuskowim Rivers and associated tributaries	Severe flooding	May 1-June 10, 1989
California Counties of Alameda, Contra Costa, Marin, Monterey, San Benito, San Francisco, San Mateo, Santa Clara, Santa Cruz, and Solano; and Cities of Isleton, San Francisco, and Tracy	Earthquake and aftershocks	October 17, 1989
Connecticut Counties of Litchfield and New Haven	Thunderstorms, tornadoes, and severe winds	July 10, 1989
District of Columbia The District of Columbia	Severe storms and high winds	June 14-15, 1989
Illinois Counties of Edwards, Hamilton, Wabash, Wayne, and White	Severe storms and tornadoes	January 7, 1989

Disaster Areas in 1989	Type of Disaster	Date Disaster Occurred or Began
Kentucky Counties of Anderson, Ballard, Berry, Bourbon, Boyd, Breathitt, Bullitt, Butler, Caldwell, Carlisle, Casey, Christian, Edmonson, Elliott, Floyd, Franklin, Graves, Grayson, Greenup, Hardin, Harrison, Hart, Henry, Hickman, Hopkins, Jackson, Jessamine, Johnson, Knott, Knox, Lawrence, Larue, Lee, Leslie, Letcher, Magoffin, Marshall, Martin, McClean, McCracken, Mercer, Morgan, Muhlenberg, Nelson, Nicholas, Ohio, Owen, Owsley, Pendelton, Perry, Pike, Rockcastle, Rowan, Trigg, Trimble, Washington, Woodford, and Wolfe	Severe storms and flooding	February 13–March 8, 1989
Counties of Bell, Breathitt, Clay, Floyd, Knott, Knox, Leslie, Letcher, Magoffin, Owsley, Pike, and Whitley	Severe storms and flooding	June 15–July 6, 1989
Counties of Clay, Floyd, Jackson, Knott, Knox, Leslie, Letcher, Magoffin, Owsley, Perry, and Pike	Severe storms, flooding, and mudslides	October 16–18, 1989
Louisiana Parishes of Acadia, Allen, Beauregard, Bienville, Caddo, Calcasieu, Caldwell, Claiborne, East Feliciana, Franklin, Grant, Jackson, LaSalle, Lincoln, Madison, Morehouse, Natchitoches, Ouachita, Red River, Richland, Sabine, St. James, St. Landry, St. Martin, Union, Vermilion, Vernon, Webster, West Carroll, and Winn	Severe storms and flooding	May 4–27, 1989
Parishes of Beauregard, East Baton Rouge, Iberville, Livingston, St. Helena, Tangipoa, Vernon, and West Baton Rouge	Severe thunderstorms and tornadoes	June 7–8, 1989
Parishes of Allen, Beauregard, Bienville, Bossier, Calcasieu, East Baton Rouge, Grant, Iberville, Jefferson Davis, Lafayette, Natchitoches, Pointe Coupee, Rapides, Sabine, St. Landry, Vermilion, Vernon, Webster, and Winn	Tropical Storm Allison	June 25–July 21, 1989
Parishes of Jefferson, Orleans, and St. Charles	Heavy rains and flooding	November 7–9, 1989
Maine Counties of Androscoggin, Cumberland, Franklin, and Oxford	Severe storms and flooding	May 5–13, 1989
Maryland Montgomery County	Severe storms and high winds	June 14–15, 1989
Minnesota Counties of Clay, Marshall, Norman, Pennington, Polk, Traverse, and Wilkin	Flooding	March 29–May 8, 1989

Disaster Areas in 1989	Type of Disaster	Date Disaster Occurred or Began
North Carolina Counties of Anson, Catawaba, Cleveland, Davidson, Davie, Durham, Forsyth, Granville, Guilford, Iredell, Lincoln, Rutherford, and Union	Tornadoes	May 5–6, 1989
Counties of Alexander, Alleghany, Anson, Ashe, Avery, Brunswick, Burke, Cabarrus, Caldwell, Catawba,Cleveland, Davidson, Davie, Forsyth, Gaston, Guilford, Iredell, Lincoln, Mecklenburg, Montgomery, Richmond, Rowan, Stanly, Stokes, Surry, Union, Watauga, Wilkes, and Yadkin	Hurricane Hugo	September 21–22, 1989
North Dakota Counties of Cass, Grand Forks, Pembina, Richland, Traill, and Walsh	Flooding	March 29–May 6, 1989
Ohio Counties of Butler, Coshocton, Cuyahoga, Franklin, Geauga, Greene, Lake, Licking, Lorain, Mercer, Montgomery, Preble, and Warren	Severe storms and flooding	May 23–June 26, 1989
Puerto Rico Municipios of Adjuntas, Aibonita, Aguas Buenas, Arecibo, Arroyo, Barceloneta, Barranquitas, Bayamon, Caguas, Camuy, Canovanas, Carolina, Catano, Cayey, Ceiba, Ciales, Cidra, Coamo, Comerio, Corozal, Culebra, Dorado, Fajardo, Florida, Guayama, Guaynabo, Gurabo, Hatillo, Humacao, Jayuya, Juncos, Lares, Las Piedras, Loiza, Luquillo, Manati, Maunabo, Morovis, Naguabo, Naranjito, Orocovis, Patillas, Penuelas, Ponce, Rio Grande, Salinas, San Juan, San Lorenzo, Toa Alta, Toa Baja, Trujillo Alto, Utuado, Vega Alta, Vega Baja, Viegues, Villalba, and Yabucoa	Hurricane Hugo	September 17–18, 1989
South Carolina Counties of Berkeley, Calhoun, Charleston, Chester, Chesterfield, Claredon, Colleton, Darlington, Dillon, Dorchester, Fairfield, Florence, Georgetown, Horry, Kershaw, Lancaster, Lee, Marion, Marlboro, Organgeburg, Richland, Sumter, Williamsburg, and York	Hurricane Hugo	September 21–22, 1989
Texas Counties of Cass, Cherokee, Gregg, Harrison, Houston, Marion, Panola, Smith, and Rusk	Severe thunderstorms and flooding	March 28–29, 1989
Counties of Anderson, Angelina, Archer, Baylor, Bell, Blanco, Bosque, Brown, Burnet, Cass, Cherokee, Clay, Collin, Comanche, Cooke, Coryell, Dallas, Denton, Donley, Ector, Ellis, Fannin, Grayson, Gregg, Hale, Hall, Hardin, Harris, Harrison, Henderson, Hill, Hood, Houston, Howard, Hutchinson, Jack,	Severe storms, tornadoes, and flooding	May 4–June 15, 1989

Disaster Areas in 1989	Type of Disaster	Date Disaster Occurred or Began
Jasper, Jefferson, Johnson, Kaufman, Knox, Lamar, Leon, Liberty, Limestone, Lubbock, Marion, Mason, McCulloch, McLennan, Montague, Montgomery, Nacogdoches, Navarro, Newton, Ochiltree, Orange, Palo Pinto, Panola, Parker, Pecos, Polk, Potter, Randall, Red River, Rockwall, Rusk, Sabine, San Augustine, San Jacinto, Shelby, Sherman, Smith, Somervell, Tarrant, Taylor, Titus, Trinity, Tyler, Upshur, Van Zandt, Walker, Waller, Williamson, Wise, Wichita, and Young		
Counties of Hardin, Harris, Jasper, Jefferson, Liberty, Newton, Orange, San Jacinto, and Tyler	Tropical Storm Allison	June 25-July 7, 1989
United States Territory of the Virgin Islands The Virgin Islands of St. Croix, St. John, St. Thomas, Water Island, and other inhabited islands under the jurisdiction of the Territorial Government	Hurricane Hugo	September 17-18, 1989
Utah Washington County	Flash flooding	January 1, 1989
Vermont Counties of Addison, Caledonia, Essex, Orange, and Washington	Severe storms and flooding	August 4-5, 1989
Virginia Buchanan County	Severe storms, flooding, and mudslides	October 16-17, 1989
Washington Counties of Douglas, Okanogan, Stevens, and Whitman	Flooding and mudslides	March 8-17, 1989

Section 168.—Accelerated Cost Recovery System

(Also Sections 38, 47, 48; 1.38-1, 1.47-1, 1.48-1.)

Alternative depreciation system; cargo containers. A taxpayer must depreciate its cargo containers under the alternative depreciation system if the taxpayer cannot document that the containers were used substantially in the direct transportation of property to and from the U.S. during the taxable year.

Rev. Rul. 90-9

ISSUE

If a taxpayer owns cargo containers used predominantly outside the United States during the taxable year but cannot document that the containers were used in the transportation of property to and from the United States, must the taxpayer depreciate the containers under the alternative system described in section 168(g) of the Internal Revenue Code?

FACTS

The taxpayer, a domestic corporation, owns intermodal cargo containers that it placed in service in 1989 for use in worldwide trade. The containers were certified as meeting the size and safety standards set forth in international agreements to which the United States is a party. The containers were physically located outside the United States more than 50 percent of the taxable year. A portion of the containers was leased to others by the taxpayer for a period not in excess of one year. The taxpayer has no records that show where or how its containers were used. The taxpayer has records that document the year the containers were placed in service, their original cost or other basis, and any retirement or other disposition of those containers.

LAW

Section 168(a) of the Code requires taxpayers to determine the depreciation deduction allowed by section 167(a) by using the applicable depreciation method, the applicable recovery period, and the applicable convention. Section 168(g)(1)(A), however, imposes an alternative depreciation system upon any tangible property that is used predominantly outside the United States during the

taxable year. To determine whether property is used predominantly outside the United States, section 168(g)(4) applies rules similar to those under section 48(a)(2) (including the exceptions in section 48(a)(2)(B)).

Section 48(a)(2) of the Code generally denies the investment tax credit to property used predominantly outside the United States. Under section 1.48-1(g)(1)(i) of the Income Tax Regulations, property is used predominantly outside the United States if it is located outside the United States during more than 50 percent of the taxable year. Section 48(a)(2)(B), however, lists certain kinds of property that qualify for the investment tax credit, even if the property is used predominantly outside the United States.

A cargo container used predominantly outside the United States qualifies for the credit under section 48(a)(2)(B)(v) of the Code if it is owned by a United States person and if it is used in the transportation of property to and from the United States. Section 1.48-1(g)(2)(v) of the regulations repeats the statutory language without further explanation.

Section 47 of the Code requires recapture of all or a portion of the investment tax credit if the property no longer qualifies as section 38 property. Section 1.46-3(e)(6) of the regulations provides that the taxpayer must maintain sufficient records to determine whether section 47 applies with respect to any asset. Section 1.47-1(e)(1) provides, in part, that in order to avoid recapture, the taxpayer must maintain records from which it can establish each item of section 38 property, the following facts: (a) the date the property is disposed of or otherwise ceases to be eligible for the investment tax credit, (b) the estimated useful life of the property, (c) the month and the taxable year in which the property was placed in service, and (d) the property's basis (or cost) as actually or reasonably determined. *See also*, section 1.6001-1.

The investment tax credit was added to the Code by the Revenue Act of 1962, Sec. 2(a), 1962-3 C.B. 111, 114. The House Ways and Means Committee stated that certain property could not qualify for the credit. Among the types of disqualified property is property used predominantly outside the United States. But the Committee noted:

> [T]here are certain exceptions where this type of property is eligible for the credit, namely, in the case of domestically owned aircraft, rolling stock of railroads, vessels, and motor vehicles, where the use is partially *within* and partially without the United States. Similarly, an exception is made in the transportation of property to or from the United States. . . . Property used predominantly outside the United States (with the exceptions noted) is omitted, since the *primary purpose of the credit is to encourage investment within the United States*.

H.R. Rep. No. 1447, 87th Cong., 2d Sess. 12 (1962), 1962-3 C.B. 405, 416 (emphasis added). Essentially identical language appears at S. Rep. No. 1881, 1962-3 C.B. 703, 717, 723.

ANALYSIS

A taxpayer must depreciate property used predominantly outside the United States according to the alternative depreciation system if that use outside the United States would have disqualified the property for the investment tax credit for the taxable year. A cargo container used predominantly outside the United States cannot qualify for the investment tax credit unless the taxpayer can demonstrate that it satisfies the exception in section 48(a)(2)(B)(v) of the Code.

Rather than establishing standards applicable to all the asset types listed, section 48(a)(2)(B) of the Code and section 1.48-1(g)(2) of the regulations set out different standards for each specific asset type. Determination of the eligibility of intermodal cargo containers by adopting portions of the standards of other exceptions set out in section 1.48-1(g)(2) of the regulations is not appropriate. For example, an intermodal cargo container is not eligible for the credit merely because it returned to the United States "with some degree of frequency." *See* section 1.48-1(g)(2)(i) and Rev. Rul. 73-367, 1973-2 C.B. 8 (relating to the eligibility requirements of aircraft). Similarly, certification that a cargo container meets international standards is not equivalent to documentation for vessels and does not assure the container's eligibility. *See* section 1.48-1(g)(2)(iii) and Rev. Rul. 69-509, 1969-2 C.B. 3 (relating to the eligibility requirements for vessels). Thus, an intermodal cargo container used predominantly outside the United States can qualify for the investment tax credit only if it satisfies the standards of section 1.48-1(g)(2)(v).

The cargo containers in this case are owned by United States persons. The issue is the meaning of "used in the transportation of property to and from the United States." The legislative history of section 48(a)(2)(B) of the Code indicates that Congress intended that the investment tax credit be available for depreciable property used predominantly outside the United States only if the activity directly and particularly benefits the United States economy. That benefit is not assured unless a cargo container is used substantially in the activity described in section 1.48-1(g)(2)(v) of the regulations. *Cf. Northville Dock Corp. v. Commissioner*, 52 T.C. 68 (1969), (finding that a storage facility, a portion of which was substantially used in connection with a qualifying activity, is eligible for the investment tax credit), *aff'd per curiam*, 427 F.2d 164 (2d Cir. 1970). Thus, a cargo container must be used substantially in the direct transportation of property to or from the United States during each taxable year of its recovery period. In view of the legislative history quoted above, the standard is expressed with the conjunction "or" rather than "and."

For this purpose, direct transportation consists of the transportation of property by the container with the United States as the origin or terminus of the trip for the container and the property. Thus, a container is not engaged in the direct transportation of property to or from the United States merely because it transports property from one foreign country to another foreign country, even if the property inside the container may eventually come to the United States, whether in its original form or integrated into a new product.

In this case, the taxpayer has no records to document the annual activity of any of its intermodal cargo containers used predominantly outside the United States and is thus unable to determine whether any con-

tainer is eligible for the credit under the exception. Under these facts, the taxpayer must use the alternative depreciation system of section 168(g) of the Code.

If the costs of a taxpayer's cargo containers were eligible under section 48(a)(2)(B)(v) of the Code when placed in service to be depreciated under the general depreciation system of section 168(a), they must be depreciated under the alternative depreciation system if in any subsequent taxable year of the recovery period no records were kept substantiating continued qualifying use. Such a failure to maintain records will be treated as a change in use under section 168(i)(5) for purposes of determining the subsequent depreciation deduction.

Taxpayers lacking adequate records to establish whether its cargo containers qualify, or continue to qualify under section 48(a)(2)(B)(v) of the Code for depreciation under section 168(a) may be eligible to make an irrevocable election to use "safe harbor" percentages set out in Rev. Proc. 90-10, page 467, this Bulletin, to establish the level of qualification for certain intermodal cargo containers placed in service in the year of election.

HOLDING

A taxpayer must depreciate its cargo containers under the alternative depreciation system of section 168(g) of the Code if the taxpayer cannot document that the containers were used substantially in the direct transportation of property to or from the United States during the taxable year. However, the taxpayer may be eligible for the irrevocable election set out in Rev. Proc. 90-10.

Section 170.—Charitable, etc., Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc. contributions and gifts; allowance of deduction.

Guidelines on when benefits received in connection with a payment to charity will be considered to have insubstantial fair market value for purposes of advising patrons how much is deductible and how much is not. See Rev. Proc. 90-12, page 471.

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26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Revised procedures are provided for issuing rulings and determination letters in response to applications for recognition of exemption from federal income tax. See Rev. Proc. 90-27, page 514.

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26 CFR 1.170A-6: Charitable contributions in trust.

Contributions to a qualifying charitable remainder unitrust that meets the requirements of section 664(d)(2) of the Code and provides for unitrust payments for one or two measuring lives are deductible for income tax purposes, assuming that all other applicable requirements for a charitable contribution are met. See Rev. Proc. 90-30, page 534.

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26 CFR 1.170A-6: Charitable contributions in trust.

Contributions to a qualifying charitable remainder unitrust that meets the requirements of section 6614(d)(2) and (3) of the Code and provides for unitrust payments for one or two measuring lives are deductible for income tax purposes, assuming that all other applicable requirements for a charitable contribution are met. See Rev. Proc. 90-31, page 539.

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26 CFR 1.170A-6: Charitable contributions in trust.

Contributions to a qualifying charitable remainder annuity trust that meets the requirements of section 664(d)(1) of the Code and provides for annuity payments for one or two measuring lives are deductible for income tax purposes, assuming that all other applicable requirements for a charitable contribution are met. See Rev. Proc. 90-32, page 546.

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26 CFR 1.170A-6: Charitable contributions in trust.

The Service ordinarily will not issue rulings as to whether a transfer to an inter vivos charitable remainder trust described in section 664 of the Code that provides for annuity or unitrust payments for one or two measuring lives qualifies for a charitable deduction under section 170(f)(2)(A). See Rev. Proc. 90-33, page 551.

Section 189.—Amortization of Real Property Construction Period Interest and Taxes

In determining the amount of interest expense that is required to be capitalized under former section 189 of the Code, a taxpayer may not reduce the amount of interest expense required to be capitalized by the amount of interest income earned from temporarily investing the unexpended debt proceeds. See Rev. Rul. 90-40, page 52.

Section 216.—Deduction of Taxes, Interest, and Business Depreciation by Cooperative Housing Corporation Tenant-Stockholder

26 CFR 1.216-1: Amounts representing taxes and interest paid to cooperative housing corporation.

Cooperative housing corporation; nonresidential units; deduction of taxes, interest and business depreciation. Conditions under which allocating shares of stock to non-residential apartments will not prevent a cooperative housing corporation from meeting the requirements of section 216(b)(1)(B) of the Code. Rev. Rul. 58-421 modified and superseded; Rev. Rul. 74-241 amplified.

Rev. Rul. 90-35

ISSUE

Under what circumstances will the allocation of shares of a cooperative housing corporation to nonresidential units permit the corporation to remain qualified as a cooperative housing corporation under section 216 of the Internal Revenue Code ?

FACTS

Situation 1. *X* Corporation is a cooperative housing corporation, as defined in section 216(b)(1) of the Code, that owns land and a building thereon containing apartments. All units in the multistory building are residential apartments, except for three units on the ground floor that are leased for use as professional offices. All of *X*'s issued and outstanding shares are allocated to the residential apartments in the building.

X proposes also to allocate authorized but unissued shares to the professional office units and sell them to the corporate or individual occupants of those offices. The professional units are structurally similar to residential units in the building. Although the offices do not contain sleeping or cooking facilities, they do contain one or more rooms that contain sanitation facilities normally found in a dwelling unit. Moreover, it would be reasonable to add sleeping and cooking facilities normally found in a dwelling unit to the office units under all the facts and circumstances. The cost of adding sleeping and cooking facilities is equal to approximately

20 percent of the fair market value the professional units would have if they were sold as residential units. Ownership of the shares attributable to the office units would entitle the tenant-stockholders to install sleeping and cooking facilities and occupy the units for dwelling purposes upon approval of the board of directors of the corporation. *X* has agreed that such approval would not be unreasonably withheld and that it would cooperate in effecting the conversion.

The entire building, including the professional office units, is located in an area that is zoned for residential use, except that the ground floor may have certain enumerated nonresidential uses that include use as professional offices. The ground floor units could be converted from office use to residential apartment use as a matter of right under the applicable local zoning, building, and fire codes.

Situation 2. The facts are the same as in *Situation 1*, except that shares allocated to one of the professional offices will be sold to a third party and not the current occupant. The existing commercial lease has one year to run until it terminates. If shares are allocated to the unit and sold to a third party, the third party will succeed to the lessor's rights and obligations under the existing commercial lease.

Situation 3. The facts are the same as in *Situation 1*, except that the building already has the maximum number of residential units permitted under the local zoning code. A zoning variance would have to be obtained from the local zoning authority in order to obtain permission to convert the office units to residential units.

LAW AND ANALYSIS

Section 216(a) of the Code allows a tenant-stockholder to deduct amounts paid or accrued to a cooperative housing corporation within the taxable year to the extent that the amounts represent the tenant-stockholder's proportionate share of certain real estate taxes allowable as a deduction to the corporation under section 164, and certain interest allowable as a deduction to the corporation under section 163.

Section 216(b)(2) of the Code, in part, defines the term "tenant-stockholder" to mean a person who is a stockholder in a cooperative housing corporation.

The term "cooperative housing corporation" is defined in section 216(b)(1) of the Code to mean a corporation (A) that has only one class of stock outstanding; (B) each stockholder of which is entitled, solely by reason of stock ownership in the corporation, to occupy for dwelling purposes a house or an apartment in a building leased or owned by the corporation; (C) no stockholder of which is entitled to receive any distribution not out of earnings and profits except on a complete or partial liquidation of the corporation; and (D) that derives 80 percent or more of its gross income from tenant-stockholders.

Section 1.216-1(d)(2) of the Income Tax Regulations provides that, in order for the corporation to qualify as a cooperative housing corporation, each stockholder of the corporation must be entitled to occupy for dwelling purposes an apartment in a building or a unit in a housing development owned or leased by the corporation. The stockholder is not required to occupy the premises. The right as against the corporation to occupy the premises is sufficient if conferred on each stockholder solely by reason of ownership of stock in the corporation. That is, ownership of the stock must entitle the owner either to occupy the premises or to lease the premises.

Rev. Rul. 80-299, 1980-2 C.B. 82, holds that actual occupancy of certain apartment units by stockholders of a corporation is not required for purposes of satisfying section 216(b)(1)(B) of the Code when those units are occupied by non-stockholder tenants protected under rent control laws.

Rev. Rul. 74-241, 1974-1 C.B. 68, provides that, for purposes of section 216(b)(1)(B) of the Code, the term "apartment in a building" means an independent housekeeping unit consisting of one or more rooms that contain facilities for cooking, sleeping, and sanitation normally found in a principal residence.

Rev. Rul. 74-241 does not require, however, that a unit presently contain all the facilities normally found in a principal residence in order to constitute an apartment in a building for purposes of section 216(b)(1)(B) of the Code. Accordingly, a unit will be treated as meeting that definition if (1) the stockholder is entitled to convert the unit to an apartment, as defined in Rev. Rul. 74-241, solely by reason of ownership of stock in the cooperative housing corporation; (2) the conversion of the unit would be reasonable under all the facts and circumstances, including structural feasibility and cost; and (3) the applicable local zoning, building, and fire codes permit both the conversion referred to in (1) and residential use of the unit as a matter of right.

Whether conversion of a unit to residential use is reasonable will depend on all the facts and circumstances. Generally, conversion will be reasonable where the unit is structurally similar to existing residential units in the building, has ready access to plumbing and utility sources, and the cost of converting the unit to residential use is not disproportionate to the fair market value the unit would have if the unit were sold as a residence.

Under the facts in *Situation 1*, (1) the stockholders are entitled to add sleeping and cooking facilities to convert the office units to dwelling units solely by reason of their ownership of stock in the corporation, (2) the addition of those facilities to the office units would be reasonable under all the facts and circumstances, including structural feasibility and cost, and (3) the applicable local zoning, building, and fire codes permit addition of those facilities and residential apartment use as a matter of right.

In *Situation 2*, the purchaser of shares attributable to the one unit is temporarily barred from occupancy by the existing commercial lease. Nevertheless, ownership of stock confers occupancy rights upon the stockholder as against the corporation and the fact that a current occupant has the right to remain in possession of the unit under a pre-existing lease is immaterial for purposes of section 216(b)(1)(B). See Rev. Rul. 80-299.

In *Situation 3*, the zoning restriction precludes the conversion of the units to residential use without obtaining a zoning variance, which may or may not be granted. The zoning restriction is a substantial legal im-

pediment to the conversion of the office units to residential use.

HOLDINGS

In *Situation 1*, the allocation of shares to nonresidential units will not disqualify the corporation from treatment as a cooperative housing corporation under section 216 of the Code because those units meet the definition of an apartment for purposes of section 216(b)(1)(B).

In *Situation 2*, the existence of a long term commercial lease on the nonresidential unit will not disqualify the corporation from treatment as a cooperative housing corporation under section 216 of the Code provided that the unit is capable of conversion as provided in *Situation 1* and the purchaser of the shares has the right to occupy the unit as provided in section 1.216-1(d)(2) of the regulations.

In *Situation 3*, the allocation of shares to nonresidential units will disqualify the corporation from treatment as a cooperative housing corporation under section 216 of the Code because there is a substantial legal impediment to occupying the units for residential purposes as required in section 216(b)(1)(B).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 58-421, 1958-2 C.B. 112, which holds that the sale of commercial space in a cooperative apartment building will not prevent the corporation from being classified as a cooperative housing corporation under section 216(b)(1)(B), is modified to include the conditions set forth in this revenue ruling. In addition, as a result of the Tax Reform Act of 1986, the holding of the revenue ruling that income derived from stockholders who are not individuals cannot be included as income from tenant-stockholders is obsoleted. As modified, Rev. Rul. 58-421 is superseded.

Rev. Rul. 74-241 is amplified.

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26 CFR 1.216-1: Amounts representing taxes and interest paid to cooperative housing corporation.

Section 277 of the Code applies to cooperative housing corporations, as defined by section 216(b), to determine the amount of net income the corporation derives from tenant-stockholders and nontenant-stockholders. The amount of deductions allowed to tenant-stockholders under section 216(a) may be affected by deductions disallowed under section 277. See Rev. Rul. 90-36, page 59.

Part VIII.—Special Deductions for Corporations

Section 243.—Dividends Received by Corporations

26 CFR 1.243-1: Deduction for dividends received by corporations
(Also Sections 163, 246; 385; 1.163-1, 1.246-3.)

Dutch-auction rate preferred stock; dividends received deduction. The terms of the described issue of dutch-auction rate preferred stock do not prevent the corporation receiving a dividend distribution with respect to the stock from claiming the dividend received deduction.

Rev. Rul. 90-27

ISSUES

(1) Does the dutch-auction rate preferred stock described below represent an equity interest in the issuing corporation?

(2) If a corporation holding the dutch-auction rate preferred stock described below receives a dividend distribution with respect to the stock, do the terms of the issue cause the distribution to fail to qualify for the dividends received deduction under section 243(a) of the Code?

FACTS

X, a publicly-held domestic corporation, issued 1000 shares of dutch-auction rate preferred stock for $100 million. The stock carries a liquidation preference of $100,000 per share. As a condition of sale, each prospective purchaser was required to execute a purchaser's letter, agreeing to sell shares of the *X* preferred only through a "dutch-auction" proceeding, to an authorized broker-dealer, or to a purchaser who similarly has executed a purchaser's letter.

The initial dividend rate for the preferred shares was set by *X* at the time of issue. Under a prearranged schedule (generally every 49 days), the rate is then reset pursuant to a "dutch auction," a process in which orders to purchase or sell the preferred stock are submitted through registered broker-dealers to a designated auction agent. In each auction, existing holders that wish to increase the number of shares held and potential new holders bid to purchase shares offered for sale. The stock is designed to trade at the liquidation preference ($100,000). Therefore, each bid consists of a proposed dividend rate at which the bidder is willing to purchase the offered shares at a price equal to the liquidation preference.

An existing holder may choose to hold its preferred shares at whatever rate is set for the next dividend period. Alternatively, an existing holder may place a bid order to hold its shares provided the applicable rate for the next dividend period is not below the rate specified in the bid. If the applicable rate for the next dividend period is below the specified rate, then the bid is treated as a sell order. Lastly, an existing holder may place an order to sell its shares regardless of the applicable rate. A holder may place differing orders for each of its shares.

The lowest dividend rate bid that enables all the shares offered for sale to be sold to potential purchasers is the rate that applies to all shares for the next dividend period. If all of the current holders of the preferred shares elect to hold their shares without specifying a minimum dividend rate (place hold orders on their shares), the dividend rate for the next period is 59% of the AA Composite Commercial Paper Rate.

If there are insufficient bids to purchase all of the shares offered for sale, the auction "fails" and the dividend rate is then the applicable maximum bid rate for that auction. The maximum bid rates are expressed as a percentage of the AA Composite Commercial Paper Rate. The rate applicable to a particular auction depends on the prevailing rating for the preferred stock as determined by a designated investor service:

Prevailing Rating	*Percentage*
AA/aa or above	110%
A/a	125%
BBB/baa	150%
BB/ba	200%
Below BB/ba	250%

A broker-dealer may buy and sell shares of *X* preferred in an auction both on behalf of customers and for its own account. Moreover, a broker-

dealer may "make a market," that is, trade shares for its own account with a view toward maintaining an orderly market. There is no express or implied agreement between a broker-dealer or any other party and the issuer or any holder, however, that the broker-dealer or other party will guarantee or otherwise arrange to ensure that any holder of the *X* preferred stock will be able to sell its shares.

Dividends with respect to the *X* preferred stock are cumulative and must be declared by the Board of Directors and paid out of legally available funds. Holders have no direct right to compel the payment of dividends, and there is no arrangement ensuring that dividends will be paid. However, although the preferred shares generally have no voting rights, if accrued dividends remain unpaid for a specified period, the holders of the preferred stock obtain the right to vote as a class for seats on the Board of Directors.

With proper notice, *X* may redeem part or all of the preferred shares at any time at par ($100,000) plus accrued but unpaid dividends. Holders, however, may not compel redemption. In the event of any voluntary or involuntary dissolution, liquidation, or winding up of the affairs of *X*, the holders of the preferred stock are entitled to be paid before holders of shares ranking junior. The liquidation preference is at par plus any unpaid accrued dividends. The claims of the holders of the preferred are subordinate, however, to the claims of X's creditors.

Corporation Y acquired ten shares of the auction rate preferred stock issued by *X*.

LAW AND ANALYSIS

Debt/equity issue

The initial question with respect to dutch-auction rate preferred stock is whether it is equity or debt for federal income tax purposes. This classification depends on the facts and circumstances of each case. No particular fact is conclusive in making such a determination. *John Kelley Co. v. Commissioner*, 326 U.S. 521 (1946), 1946-1 C.B. 191.

From the perspective of the holders, dutch-auction rate preferred stock is an investment alternative to commercial paper or other short-term debt. In certain critical respects, however, the legal rights embodied in the dutch-auction rate preferred described above are similar to those found in traditional preferred stock and are unlike those usually associated with debt. As a holder of the preferred, *Y* has no right to receive a sum certain either on demand or on a specified date, and, at liquidation or in bankruptcy, *Y*'s rights are subordinate to the claims of *X*'s creditors. Subject to that limitation, *X* may redeem the stock, but the holder cannot compel redemption. Moreover, *X* has not guaranteed or otherwise arranged to ensure that *Y* can sell its stock in an auction. *Y*'s receipt of dividends is dependent upon dividends being declared by *X* and paid out of legally available funds.

The terms of the dutch-auction rate preferred stock issued by *X*, including those discussed above, cause the stock to be equity for federal income tax purposes.

Holding period

The remaining question is whether section 246(c) of the Code limits *Y*'s holding period in the *X* preferred and thus precludes the dividends received deduction under section 243(a).

Under section 243(a)(1) of the Code, a corporation generally is allowed a deduction equal to 70 percent of the amount received as dividends from a domestic corporation.

Section 246(c)(1) of the Code excludes from the deduction allowed under section 243 any dividend on a share of stock that is held by the taxpayer for 45 days or less.

Section 246(c)(4) of the Code reduces the holding period of the taxpayer for any period in which (A) the taxpayer has an option to sell, is under a contractual obligation to sell, or has made (and not closed) a short sale of, substantially identical stock or securities, (B) the taxpayer is the grantor of an option to buy substantially identical stock or securities, or (C) under regulations prescribed by the Secretary, a taxpayer has diminished its risk of loss by holding one or more positions with respect to substantially similar or related property.

The dutch-auction mechanism in this case serves the dual function of resetting the dividend rate on the preferred stock and providing a vehicle for the purchase and sale of the shares. Each successful auction resets the dividend rate on the preferred stock to the rate that allows the shares to trade at par. Thus, so long as auctions are successful, the holder of the stock is protected from fluctuations in value of the stock that otherwise would result from changes in interest rates and the credit rating of the issuer. Although this protection insulates the holder from certain market risks, the legislative history of the Tax Reform Act of 1984 expressly states that an instrument providing a similar type of protection (adjustable rate preferred stock that is indexed to the Treasury bill rate) does not offer the risk diminution proscribed by section 246(c)(4)(C) of the Code. *See* H.R. Conf. Rep. No. 816, 98th Cong., 2d Sess. 817, 818 (1984), 1984-3 (Vol. 2) C.B. 71.

The auctions also provide a vehicle for the purchase and sale of shares. Although a holder of the preferred stock has the expectation of being able to sell its stock in any auction, there is no guarantee that a holder will be able to do so. In other words, the holder does not have an option to sell.

Section 246(c)(4) may apply not only if the holder has a formal option to sell, but also if the holder has rights equivalent to an option to sell. For example, if a broker-dealer had agreed to guarantee the success of each auction, *Y* would have had the equivalent of an option to sell its stock at each auction. Similarly, if *X* were in such a position that it had no practical alternative but to redeem the stock in the event of a failed auction, the combination of the auction mechanism and the forced redemption would give *Y* the equivalent of an option to sell its stock. Such facts, however, are not present here.

If an auction fails, the dividend rate for the next dividend period automatically resets to the maximum rate. This rate, which depends upon the rating of the preferred stock and is determined as a percentage of the commercial paper rate, may substantially exceed the rate that would be anticipated in a successful auction. The resulting rate may provide *X* with an incentive to redeem the stock

rather than pay the increased dividends. On the facts presented, however, the maximum rate is not so high that it assures *Y* that the failure of an auction will be followed by a redemption of the stock. Moreover, the circumstances under which an auction is likely to fail (e.g., unforeseen financial difficulties of *X*) raise serious doubts as to whether *X* would be able to redeem the preferred stock even if the reset dividend rate provided it with a significant incentive to do so. Thus, the combination of the auction mechanism and the dividend increase following a failed auction do not give *Y* rights equivalent to an option to sell.

HOLDINGS

(1) The dutch-auction rate preferred stock described above represents an equity interest in the issuing corporation.

(2) Neither the dutch-auction mechanism, the dividend increase required following a failed auction, nor any other term of the dutch-auction rate preferred stock described above prevents a corporation receiving a dividend distribution with respect to the stock from claiming the dividends received deduction under section 243(a) of the Code.

APPLICATION

The terms of some existing issues of dutch-auction rate preferred stock are distinguishable from those of the stock described in this ruling and provide holders additional rights that result in greater diminution of risk and that are of a type usually associated with debt. Pursuant to the authority contained in section 7805(b) of the Code, with respect to any dutch-auction rate preferred stock issued before March 15, 1990, the Internal Revenue Service will not seek: (1) to recharacterize the stock as debt; or (2) to apply the limitations under section 246(c)(4) to the stock on the basis of the terms of the stock or other arrangements entered into in connection with the issuance of the stock. This relief does not apply where there exists an agreement or other arrangement that effectively guarantees that a holder can sell its shares. In these situations, section 246(c)(4) applies to reduce the holding period of the taxpayer for purposes of section 246(c)(1).

Although this ruling deals only with dutch-auction rate preferred stock, no adverse inference is intended with respect to issues of preferred stock in which a remarketing arrangement is used to reset the dividend rate.

Section 246.—Rules Applying to Deductions for Dividends Received

The terms of the described issue of dutch-auction rate preferred stock do not prevent the corporation receiving a dividend distribution with respect to the stock from claiming the dividend received deduction. See Rev. Rul. 90-27, page 50.

Part IX.—Items Not Deductible

Section 262.—Personal, Living, and Family Expenses

26 CFR 1.262-1: Personal, living and family expenses.

Whether daily transportation expenses paid or incurred by a taxpayer in going between the taxpayer's residence and a temporary work location are deductible business expenses under section 162(a) of the Code. See Rev. Rul. 90-23, page 28.

Section 263A.—Capitalization and Inclusion in Inventory Costs of Certain Expenses

26 CFR 1.263A-1T: Capitalization and inclusion in inventory costs of certain expenses. (Also Section 189.)

Capitalization of interest. Interest expense required to be capitalized may not be reduced by interest income earned from temporary investments.

Rev. Rul. 90-40

ISSUE

In determining the amount of interest expense that is required to be capitalized under section 263A(f) and former section 189 of the Internal Revenue Code, may a taxpayer reduce the amount of interest expense required to be capitalized by the amount of interest income earned from temporarily investing unexpended debt proceeds?

FACTS

Situation 1

The taxpayer, *X*, is a manufacturing corporation that uses an accrual method of accounting and files a return on a calendar-year basis. In 1985, *X* entered into a contract with *Y*, under which *Y* was to construct an addition to *X*'s factory. The contract requires *X* to make progress payments during the construction of the addition.

X financed the factory addition with restricted tax-exempt private activity bonds (its only borrowing during the period in issue) that have a face amount of $5,000,000 and bear a 7 percent annual rate of interest. The bonds were issued by an industrial development authority created by state *M*, and the proceeds of the bond issue were lent to *X*. The agreement between *M* and *X* required a trustee to deposit the bond proceeds in a construction fund that was to be used to make payments to *Y* as progress payments became due under the construction contract. *X* was restricted by the agreement to use the bond proceeds exclusively for the construction of the factory addition.

During construction, the trustee is required by the agreement to invest any bond proceeds that are not required for progress payments. The trustee also must transfer the interest earned on these investments to a bond sinking fund to pay interest and principal on the bonds. Pursuant to the agreement, the trustee deposited the entire $5,000,000 of bond proceeds in the construction fund on January 1, 1986. The trustee made a progress payment of $500,000 to *Y* on July 1, 1986, when *Y* began construction of the factory addition. In addition, *X*'s basis in the land allocable to the factory addition was $500,000.

During 1986, the unexpended bond proceeds were invested in short-term investments that earned a 6 percent annual rate of interest. Thus, for 1986, *X* incurred total interest expense of $350,000 ($5,000,000 x .07) on the bonds and earned interest income of $285,000 ([$5,000,000 x .06 x 6/12] + [$4,500,000 x .06 x 6/12]) from the short-term investments held by the trustee. Of the $350,000 total amount of interest expense, $35,000 ($1,000,000 x .07 x 6/12) was related to the underlying land and other construction expenditures. For financial statement purposes, *X* capitalized, as its total interest cost of constructing

the addition for 1986, $350,000 of interest expense that accrued on the bonds less $285,000 of interest income earned from the short-term investments. Because the total capitalized interest expense exceeded the total interest income by $65,000, *X* increased the cost basis of the factory addition by $65,000 for financial accounting purposes.

This treatment conforms with Financial Accounting Standards Board (FASB) Statement No. 34, *Capitalization of Interest Cost* (as amended by FASB Statement No. 62). FASB Statement No. 34 generally requires an entity to capitalize the amount of interest expense that could have been avoided if the expenditures had not been made, and prohibits the netting or offsetting of interest income and interest expense. However, a special rule is provided pursuant to FASB Statement No. 62 for the capitalization of interest expense incurred on restricted tax-exempt borrowings. This special rule requires the capitalization of all interest expense incurred less any interest income earned on interest-bearing investments that are acquired with the proceeds of the tax-exempt borrowing.

The first part of this revenue ruling addresses whether *X* may similarly net interest income and interest expense for purposes of former section 189 of the Code.

Situation 2

Assume the same facts as in *Situation 1*, except that the construction commenced in 1988 pursuant to a contract between *X* and *Y* entered into in 1987. The second part of this ruling addresses whether *X* may net interest income and interest expense for purposes of section 263A(f) of the Code.

LAW AND ANALYSIS

Under the facts presented, the taxpayers have incurred total tax-exempt borrowings that exceed the cumulative amount of construction expenditures that are subject to former section 189 of the Code or section 263A(f) for the tax years in issue. To the extent that a taxpayer has temporarily invested the excess tax-exempt debt proceeds in income-earning assets, the taxpayer is earning additional interest income that could be used to pay interest expense on construction expenditures. This ruling addresses whether the taxpayers' interest income on the unexpended debt proceeds may reduce the amount of interest expense subject to capitalization for the year.

Taxpayers were required to capitalize real property construction period interest incurred before January 1, 1987, under former section 189(a) of the Code (repealed by the Tax Reform Act of 1986, section 803(b)(1), 1986-3 (Vol. 1) C.B. 272). Former section 189(e)(1)(A) defines real property construction period interest as interest paid or accrued on indebtedness incurred or continued to acquire, construct, or carry real property to the extent such interest is attributable to the construction period and would otherwise be allowable as a deduction for the tax year in which paid or accrued. The construction of an addition to an existing building is a real property construction activity and, thus, is subject to the interest capitalization requirements of former section 189.

The legislative history underlying former section 189 of the Code indicates that rules similar to the avoided cost method required by FASB Statement No. 34, as amended, are appropriate to determine the amount of interest to be capitalized under that section. *See* H.R. Conf. Rep. No. 760, 97th Cong., 2d Sess. 484-85 (1982), 1982-2 C.B. 600, 608. As described by FASB Statement No. 34, the avoided cost method is a mechanical method for determining the amount of interest expense that is properly treated as a cost of an asset. The amount of interest costs to be capitalized is determined by multiplying the average accumulated expenditures for an asset for the year by the weighted average interest rate applicable to an entity's outstanding borrowings for that year. Under the avoided cost method, except for determining the order in which debt is allocated to expenditures, the use of debt proceeds is irrelevant and, therefore, has no effect on the interest capitalization rate.

In the case of assets that are financed with certain restricted tax-exempt borrowings, FASB Statement No. 62 provides a special capitalization method that expressly departs from the general avoided cost principles. Under this special rule, all interest incurred on a restricted tax-exempt borrowing must be capitalized beginning on the date of the borrowing, and without regard to whether expenditures for construction have been made. In the context of this requirement, interest income earned on related interest-bearing investments acquired with the proceeds of the tax-exempt borrowing is netted against interest expense that would otherwise be capitalized to the asset.

In contrast, the capitalization of interest under former section 189 of the Code begins only after the construction activities have commenced, and only with respect to construction expenditures that have been incurred. Former section 189 contains no exceptions or special rules for assets that are financed with restricted tax-exempt financing. Therefore, for purposes of applying former section 189, a taxpayer may not net interest income against interest expense.

In general, section 263A(a)(1)(B) of the Code requires the capitalization of direct costs and certain indirect costs incurred after December 31, 1986, with respect to real or tangible personal property produced by the taxpayer.

Section 263A(g)(2) of the Code and section 1.263A-1T(b)(2)(iv)(C) of the temporary Income Tax Regulations provide that a taxpayer is treated as producing any property produced for the taxpayer under a contract with the taxpayer to the extent that the taxpayer makes payments or incurs costs with respect to the property.

Section 263A(f) of the Code provides that interest expense is required to be capitalized with respect to property produced by the taxpayer if the property has a long useful life (real property or tangible personal property with a class life of 20 years or more), has an estimated production period exceeding 2 years, or has an estimated production period exceeding 1 year and a cost exceeding $1,000,000. The construction of an addition to an existing building is a real property production activity and, thus, is subject to the interest capitalization requirements of section 263A(f).

Notice 88-99, 1988-2 C.B. 422, provides guidance concerning the requirement to capitalize interest with respect to property that is subject to section 263A(f) of the Code. In gen-

eral, a taxpayer must capitalize the interest expense that is incurred on the total debt directly attributable to production activities ("traced debt"). If the taxpayer's accumulated production expenditures exceed the amount of traced debt, interest on the taxpayer's other outstanding debt is also required to be allocated to accumulated production expenditures, to the extent of the excess ("avoided cost debt").

Under the method described in Notice 88-99, a taxpayer capitalizes the amount of interest expense that would have been avoided if the taxpayer had used its accumulated production expenditures to repay its outstanding traced and avoided cost debt. If the taxpayer's accumulated production expenditures exceed the total amount of its traced and avoided cost debt, the maximum amount of interest expense that is capitalized is the total amount of interest expense actually incurred by the taxpayer. *See* S. Rep. No. 313, 99th Cong., 2d Sess. 144 (1986), 1986-3 (Vol. 3) C.B. 144.

In enacting section 263A(f) of the Code, Congress stated that rules similar to those applicable under former section 189 are to determine whether debt is incurred or continued to finance the production of property. Thus, section 263A(f) also incorporates the general principles of FASB Statement No. 34, as amended by FASB Statement No. 62, for applying the avoided cost method. S. Rep. No. 313, 99th Cong., 2d Sess. 144 (1986), 1986-3 (Vol. 3) C.B. 144; *see also* 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-309 (1986), 1986-3 (Vol. 4) C.B. 309.

As with former section 189 of the Code, the capitalization of interest under section 263A(f) begins only after the production activities have commenced and only with respect to production expenditures that have been incurred. Accordingly, the netting of interest income and expense in the case of assets that are financed with restricted tax-exempt borrowings as provided by FASB Statement No. 34, as amended by FASB Statement No. 62, is similarly inconsistent with the interest capitalization required by section 263A(f). Therefore, for purposes of applying section 263A(f), a taxpayer may not net interest income against interest expense. *See also* section III of Notice 88-99, Example (3).

HOLDING

In determining the amount of interest expense that is required to be capitalized under former section 189 of the Code and section 263A(f), a taxpayer may not reduce the amount of interest expense required to be capitalized by the amount of interest income earned from temporarily investing unexpended debt proceeds.

Situation (1)

X is required to capitalize under former section 189 of the Code construction period interest attributable to indebtedness incurred or continued to acquire, construct, or carry the factory addition. Under former section 189, *X* has cumulative construction expenditures for 1986 equal to the $500,000 progress payment to *Y* on July 1, 1986, plus *X*'s $500,000 basis in the land allocable to the factory addition, for a total of $1,000,000. Therefore, beginning on July 1, 1986, $1,000,000 of the total bond principal is treated as indebtedness incurred or continued to acquire the factory addition. Because this $1,000,000 portion of the bond principal accrued interest expense for 6 months at an annual rate of 7 percent, *X* is required to capitalize interest expense of $35,000 for 1986 without an offsetting reduction for the amount of interest income earned on the short-term investments.

Situation (2)

X is required to capitalize under section 263A(f) of the Code interest paid or incurred on indebtedness allocable to accumulated production expenditures for the factory addition. Under section 1.263A-1T(b)(2)(iv)(C) of the temporary regulations and Notice 88-99, *X* is treated as producing the factory addition to the extent of progress payments that are made to *Y* and costs incurred directly by *X*. Under section 263A(f), *X* has cumulative construction expenditures for 1988 equal to the $500,000 progress payment to *Y* on July 1, 1988, plus *X*'s $500,000 basis in the land allocable to the factory addition, for a total of $1,000,000. Therefore, beginning on July 1, 1988, $1,000,000 of the total bond principal is allocable to the production of property subject to section 263A(f). (As described in Notice 88-99, the remaining $4,000,000 of bond principal is treated as avoided cost debt to the extent that *X* has production expenditures for other activities that are subject to section 263A(f).) Because this $1,000,000 portion of the bond principal accrued interest expense for 6 months at an annual rate of 7 percent, *X* is required to capitalize interest expense of $35,000 for 1988 without a reduction for the amount of interest income earned on the short-term investments.

APPLICATION

A change to the method of capitalizing interest described in the holding of this revenue ruling is a change in method of accounting to which sections 446(e) and 481 of the Code and the related regulations apply. Accordingly, taxpayers who netted interest income and interest expense in determining the amount of interest capitalized under former section 189 or section 263A(f) are required to change their method of accounting to the extent that the net amount of interest previously capitalized has not been recovered through amortization, depreciation, or cost of goods sold. This change in method of accounting must be made in accordance with the requirements of Rev. Proc. 84-74, 1984-2 C.B. 736. Accordingly, taxpayers must file Form 3115 (Application for Change in Accounting Method) with the National Office within 180 days after the beginning of the year for which the change is requested. Moreover, with respect to this change in method of accounting, this ruling is identified as a designated ruling pursuant to section 5.12(2) of Rev. Proc. 84-74.

Section 265.—Expenses and Interest Relating to Tax-Exempt Income

(Also Sections 163, 291, 482, 585, 1502; 1.482-1, 1.1502-13.)

Interest expense of financial institutions. Guidelines are set forth regarding the disallowance, under section 265(b) of the Code, of interest expense allocable to tax-exempt obligations held by financial institutions.

Rev. Rul. 90-44

PURPOSE

This revenue ruling sets forth guidelines with respect to the disallowance, pursuant to section 265(b) of the Internal Revenue Code, of interest expense allocable to tax-exempt obligations held by financial institutions.

LAW

Section 265(b)(1) of the Code provides that, in the case of a financial institution, no deduction is allowed for that portion of the taxpayer's interest expense that is allocable to tax-exempt interest. Section 265(b) is effective for tax years ending after December 31, 1986.

Section 265(b)(2) of the Code provides that the portion of the taxpayer's interest expense that is allocable to tax-exempt interest is an amount that bears the same ratio to such interest expense as the taxpayer's average for the tax year of the adjusted bases of tax-exempt obligations acquired after August 7, 1986, bears to the average for the tax year of the adjusted bases of all assets of the taxpayer.

Under section 265(b)(3) of the Code, "qualified tax-exempt obligations" as defined in section 265(b)(3)(B) are provided an exception from the rule of section 265(b)(1). Any qualified tax-exempt obligation acquired after August 7, 1986, is treated for purposes of sections 265(b)(2) and 291(e)(1)(B) as if it were acquired on August 7, 1986.

Section 265(b)(4)(A) of the Code defines "interest expense" as the aggregate amount allowable to the taxpayer as a deduction for interest for the taxable year (determined without regard to sections 265(b) and 291). For this purpose, "interest" includes, but is not limited to, amounts (whether or not designated as interest) paid in respect of deposits, investment certificates, or withdrawable or repurchasable shares.

Section 265(b)(4)(B) of the Code provides that a "tax-exempt obligation" is any obligation the interest on which is wholly exempt from taxes imposed by subtitle A of the Code. Interest is wholly exempt from taxes imposed by subtitle A if it is—

(1) wholly excluded from gross income under any provision of subtitle A other than section 597(a), or

(2) wholly exempt from the taxes imposed by subtitle A under the provisions of any law as provided in section 149(c)(2).

Compare section 1.265-1(b)(1) of the Income Tax Regulations. Section 59(i) provides that interest does not fail to be treated as wholly exempt from tax imposed by subtitle A solely by reason of being included in alternative minimum taxable income. Section 265(b)(4)(B) also provides that the term "tax-exempt obligation" includes shares of stock of a regulated investment company that during the tax year of the holder of the stock thereof distributes exempt-interest dividends.

Section 265(b)(5) of the Code defines a "financial institution" as any person that 1) accepts deposits from the public in the ordinary course of such person's trade or business and is subject to federal or state supervision as a financial institution, or 2) is a corporation described in section 585(a)(2).

Section 291 of the Code, in part, disallows 20 percent of the amount allowable as a deduction with respect to any financial institution preference item. The term "financial institution preference item" includes a financial institution's interest expense that is allocable to tax-exempt obligations acquired after December 31, 1982, and before August 8, 1986. Tax-exempt obligations acquired after August 7, 1986, in a tax year ending in 1986 are subject to the 20 percent disallowance rule of section 291 for the tax year ending in 1986 and are subject to section 265(b) for subsequent tax years. 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-334 (1986), 1986-3 (Vol. 4) C.B. 334.

ANALYSIS AND HOLDINGS

Obligations acquired after August 7, 1986

For purposes of section 265(b)(2) of the Code, a tax-exempt obligation is treated as acquired after August 7, 1986, if the taxpayer's holding period with respect to the obligation as determined under section 1223 (which generally begins on the day after the acquisition date) begins after August 8, 1986. If, under section 1223, the taxpayer's holding period is determined by reference to the holding period of the transferor, the acquisition is not treated as a new acquisition for purposes of section 265(b)(2). Thus, the acquisition of bonds as part of a tax-free reorganization is not treated as a new acquisition for purposes of this provision. 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II-333 (1986), 1986-3 (Vol. 4) C.B. 333. Tax-exempt obligations acquired after August 7, 1986, pursuant to a direct or indirect written commitment to purchase or repurchase such obligations entered into before September 25, 1985, are treated as if acquired before August 8, 1986. Section 902(f) of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 299.

For purposes of section 1001 of the Code, if there is a material change in the terms of an obligation, the old obligation is deemed to have been exchanged for a newly issued obligation. *See* Rev. Rul. 81-169, 1981-1 C.B. 429, Rev. Rul. 87-19, 1987-1 C.B. 249, and Rev. Rul. 89-122, 1989-2 C.B. 200. Thus, if a material change in the terms of a tax-exempt obligation occurs after August 7, 1986, section 265(b)(2) applies to the obligation unless the obligation is designated by the issuer at the time of the deemed reissuance as a "qualified tax-exempt obligation" and the obligation satisfies the other requirements of section 265(b)(3).

If under section 338(a)(2) of the Code a tax-exempt obligation is treated as having been purchased by a target corporation, that obligation shall be treated as having been acquired, for purposes of section 265(b), on the day after the first day on which there is a qualified stock purchase with respect to the stock of the target corporation (*i.e.*, the acquisition date as defined in section 338(h)(2)).

If one member of an affiliated group (as defined in section 1504 of the Code) transfers a tax-exempt obligation to another member of the same group, the obligation is treated as having been acquired by the transferee on the date that it would be so treated under section 1502 and the regulations thereunder. Thus, for example, if one member of an affiliated group purchases a tax-exempt obligation from a member of the same group in a deferred intercompany transaction, the obligation is treated as having been acquired by the pur-

chasing member on the date of that purchase. *See* section 1.1502-13(g) of the regulations.

Interest expense

"Interest expense" as defined in section 265(b)(4)(A) of the Code includes any amount that is treated as interest for purposes of the Code. It therefore includes amounts of original issue discount allowable as a deduction under section 163(e). In addition, a tracing concept is not used for purposes of section 265(b) of the Code; therefore, even if debt is directly or indirectly incurred to acquire assets other than tax-exempt obligations, the interest expense attributable to that debt must be taken into account under section 265(b).

However, if a deduction for interest expense on any indebtedness is disallowed under section 265(a) of the Code on the grounds that the indebtedness was incurred or continued to purchase or carry a tax-exempt obligation, the disallowed interest expense is not taken into account for purposes of applying section 265(b). For purposes of applying section 265(b)(2), the adjusted basis of any such tax-exempt obligation is reduced (but not below zero) by the outstanding principal amount of indebtedness incurred or continued to purchase or carry the obligation. *See* section 265(b)(6).

The disallowance rule of section 265(b) of the Code is to be applied before any provision that requires capitalization of interest expense. Thus, an amount disallowed under section 265(b) may not be added to the basis of any asset.

Financial institutions

Section 265(b)(5) of the Code provides that a "financial institution" is any person that 1) accepts deposits from the public in the ordinary course of such person's trade or business and is subject to federal or state supervision as a financial institution, or 2) is a corporation described in section 585(a)(2). Therefore, a "financial institution" includes, but is not limited to, any taxpayer to which section 291(a)(3), 581, 585, 591, or 593 applies, such as a bank (including a foreign bank doing business within the United States), a mutual savings bank, a cooperative bank, a domestic building and loan association, a savings and loan association, or a similar savings institution. For purposes of determining whether or not an entity not described above is one to which section 265(b) applies, the term "deposits" has the meaning set forth in 12 U.S.C. section 1813(l)(l) (1982) and includes, but is not limited to, demand deposits, time deposits, certificates of deposit, repurchase agreements, short-term notes, investment certificates, and withdrawable or repurchasable shares. For the same purposes, a person is considered subject to federal or state supervision as a financial institution if it is subject to the supervision of the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, or a similar state agency.

Determination of interest expense allocable to tax-exempt obligations

A calculation of the average for the tax year of the adjusted bases of tax-exempt obligations, and total assets, held each day is the most accurate method for determining under section 265(b)(2) of the Code the portion of a financial institution's interest expense that is allocable to tax-exempt interest. However, the Service generally will allow the average adjusted bases of tax-exempt obligations for a tax year to be calculated using the average of the adjusted bases of tax-exempt obligations held by the taxpayer at the end of each month ending within the tax year. The Service generally will allow the average adjusted bases for all assets of the taxpayer for the tax year to be calculated using the average of the adjusted bases of all assets held by the taxpayer at the end of each quarter of the tax year. A taxpayer may compute for any tax year, without prior permission, the average adjusted bases of tax-exempt obligations or total assets on a more frequent basis than set forth above. However, a taxpayer may not compute such averages for any tax year on a less frequent basis than above without obtaining prior approval of the District Director. This permission will be granted only in extraordinary circumstances. In addition, a taxpayer may not compute such averages for any tax year on a less frequent basis than it used for the preceding tax year unless the taxpayer obtains prior approval of the District Director.

The purpose of the computations described in the preceding paragraph is to produce amounts that are fairly representative of the amounts that the taxpayer would compute if a daily average were used. If the District Director determines that a computation permitted above produces results that are not fairly representative of the average adjusted bases of tax-exempt obligations, or total assets, held by a financial institution during a tax year, then the taxpayer shall be required to use a method of computation prescribed by the District Director to fairly represent the average adjusted bases of tax-exempt obligations or total assets. For example, if a manipulation of assets distorts a computation permitted above, the District Director may require a different computation method.

The adjusted bases of a taxpayer's assets shall be determined under section 1011 of the Code, with appropriate adjustments under section 1016, and shall be determined by reference to the financial institution's books and records maintained for tax purposes ("tax bases"), rather than those maintained for financial reporting purposes ("book bases").

However, a taxpayer may elect to use an estimate of the adjusted tax bases of its total assets for each of the first three quarters of the taxable year. This estimate is determined as shown in Table 1. The estimate is based on the book bases of the taxpayer's total assets at the end of each quarter, and it reflects an assumption that any change in the ratio between the tax and book bases of those assets occurs ratably during the taxable year.

Table 1
Rev. Rul. 90-44

Estimate of Tax Bases of Total Assets

1st Quarter Estimate = B x (R + ¼Y)
2nd Quarter Estimate = B x (R + ½Y)
3rd Quarter Estimate = B x (R + ¾Y)

Where:

B = Total book bases of all assets held by the taxpayer at the end of the quarter

R = "Tax/book ratio" as of the close of the preceding taxable year

Y = The result (whether positive or negative) obtained when R is subtracted from the "tax/book ratio" as of the close of the current taxable year

For purposes of determining R and Y, a taxpayer's "tax/book ratio" is the ratio of (1) the total tax bases of all of the taxpayer's assets to (2) the total book bases of those assets.

For example, assume that the adjusted tax bases of a calendar year taxpayer's total assets are $450z on December 31, 1989, and $480z on December 31, 1990. Also assume that the book bases of those assets are $500z on December 31, 1989; $520z on March 31, 1990; $540z on June 30, 1990; $560z on September 30, 1990; and $600z on December 31, 1990. Applying the estimation method shown in Table 1, the taxpayer's "tax/book ratio" as of the close of 1989 ("R"), is 0.9 (450z/500z). The taxpayer's "tax/book ratio" as of the close of 1990 is 0.8 (480z/600z).

Thus, "Y" is −0.1. The estimated adjusted tax bases of the taxpayer's total assets are as follows:

1st Qtr = B x (R + ¼Y)
= $520z x [0.9 + ¼(−0.1)]
= $455z
2nd Qtr = B x (R + ½Y)
= $540z x [0.9 + ½(−0.1)]
= $459z
3rd Qtr = B x (R + ¾Y)
= $560z x [0.9 + ¾(−0.1)]
= $462z

Any election to use this method of estimating quarterly total asset bases must be made by using the method consistently, beginning no later than the taxpayer's first taxable year ending after May 14, 1990. If a taxpayer makes this election and subsequently uses the actual adjusted tax bases of its total assets for any of the first three quarters of any taxable year, the taxpayer may not use the estimation method for any subsequent quarter in that year or any subsequent year.

Related taxpayers

If one or more financial institutions are members of an affiliated group of corporations (as defined in section 1504 of the Code), then, even if the group files a consolidated return, each such institution must make a separate determination of interest expense allocable to tax-exempt interest, rather than a combined determination with the other members of the group.

However, in situations involving taxpayers which are under common control and one or more of which is a financial institution, in order to fulfill the congressional purpose underlying section 265(b) of the Code, the District Director may require another determination of interest expense allocable to tax-exempt interest to clearly reflect the income of the financial institution or to prevent the evasion or avoidance of taxes.

Section 266.—Carrying Charges

26 CFR 1.266-1: Taxes and carrying charges chargeable to capital account and treated as capital items.
(Also Sections 446, 7805; 1.446-1, 301.7805-1.)

Carrying charges; capitalized; binding election; subsequent deductions. Unless the Commissioner consents, a taxpayer may not change from an erroneous method of accounting retroactively by amending prior returns, even if the period for amending the return for the first year in which the erroneous method was used has not expired. Rev. Rul. 70-539 revoked; Rev. Ruls. 75-56 and 76-325 modified.

Rev. Rul. 90-38

ISSUE AND FACTS

The Internal Revenue Service has reconsidered the position set forth in Rev. Rul. 70-539, 1970-2 C.B. 70. In Rev. Rul. 70-539, a corporation organized in 1966 and engaged in developing real estate capitalized interest, taxes, and other carrying charges by including them in the tax basis of real estate sold. Rev. Rul. 70-539 holds that the corporation did not make a valid election under section 266 of the Internal Revenue Code because it failed to file a statement with its returns for 1966, 1967, and 1968 identifying the items it was capitalizing as required by section 1.266-1(c)(3) of the Income Tax Regulations. Because the corporation capitalized these items without making a valid election, Rev. Rul. 70-539 holds that the corporation may treat these items as current operating expenses on amended returns for 1966, 1967, and 1968. Rev. Rul. 75-56, 1975-1 C.B. 98, distinguishes Rev. Rul. 70-539 by holding that a taxpayer may not amend its returns to deduct erroneously capitalized expenses if the period for amending the first return reflecting the capitalized expenses has expired.

LAW AND ANALYSIS

Section 446(e) of the Code and section 1.446-1(e) of the regulations

provide that a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes.

Section 1.446-1(e) of the regulations provides rules for determining what a method of accounting is, how an adoption of a method of accounting occurs, and how a change in method of accounting may be made.

Section 1.446-1(e)(2)(ii)(*a*) of the regulations provides:

> A change in the method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan. Although a method of accounting may exist under this definition without the necessity of a pattern of consistent treatment of an item, in most instances a method of accounting is not established for an item without such consistent treatment.

The treatment of a material item in the same way in determining the gross income or deductions in two or more consecutively filed tax returns represents consistent treatment of that item for purposes of section 1.446-1(e)-(2)(ii)(*a*) of the regulations. *See Diebold, Inc. v. United States*, 891 F.2d 1579 (Fed. Cir. 1989). In addition, section 1.446-1(e)(2)(i) indicates that the consistent, but erroneous, treatment of material items constitutes a method of accounting. *See* section 1.446-1(e)(2)(iii), Examples (6)-(8); *see also Fruehauf Corp. v. Commissioner*, 356 F.2d 975 (6th Cir.), *cert. denied*, 385 U.S. 822 (1966); *Commissioner v. O. Liquidating Corp.*, 292 F.2d 225 (3rd Cir.), *cert. denied*, 368 U.S. 898 (1961); and Rev. Rul. 80-190, 1980-2 C.B. 161. *Compare* Rev. Rul. 72-491, 1972-2 C.B. 104, which holds that a taxpayer erroneously using an accelerated method of depreciation for "used" property may file an amended return using a proper method, provided the taxpayer has not filed the tax return for the succeeding tax year.

If a taxpayer treats an item properly in the first return that reflects the item, however, it is not necessary for the taxpayer to treat the item consistently in two or more consecutive tax returns before it has adopted a method of accounting. Section 1.446-1(e)(1) of the regulations provides, for example, that a taxpayer filing its first return may adopt any permissible method of accounting in computing taxable income for the tax year covered by such return. Similarly, the Supreme Court has held that once a permissible election as to a method of accounting for an item has been made on a return, it may not be changed after the time for filing the return has expired. *See Pacific National Co. v. Welch*, 304 U.S. 191 (1938), 1938-1 C.B. 274; *see also Lord v. United States*, 296 F.2d 333 (9th Cir. 1961); *National Western Life Insurance Co. v. Commissioner*, 54 T.C. 33 (1970); Rev. Rul. 74-154, 1974-1 C.B. 59.

Section 1.446-1(e)(3)(i) of the regulations provides that (except as otherwise provided by administrative procedures prescribed by the Commissioner) in order to secure the Commissioner's consent to a change of a taxpayer's method of accounting, the taxpayer must file an application on Form 3115, Application for Change in Accounting Method, within 180 days after the beginning of the tax year in which the taxpayer desires to make the change.

If a taxpayer's treatment of an item is a method of accounting under these principles, section 446(e) of the Code and section 1.446-1(e)(3) of the regulations preclude a taxpayer from making a retroactive change in method of accounting by amending prior tax returns without the consent of the Commissioner. Section 446(e) authorizes the Commissioner to consent to a retroactive change in method of accounting, whether the change is from a permissible method or an impermissible method. *E.g.*, *Barber v. Commissioner*, 64 T.C. 314 (1975); Notice 89-15, 1989-1 C.B. 816; Notice 88-78, 1988-2 C.B. 394, *modified by* Notice 89-67, 1989-1 C.B. 723; Rev. Proc. 78-6, 1978-1 C.B. 558. Section 446(e) does not give the taxpayer a right to demand that a change in method be made retroactively, however. *See Diebold, Inc.*, 891 F.2d at 1583. Except in certain limited circumstances, and as specifically provided by revenue procedure or other administrative pronouncement, a taxpayer that seeks to change its method of accounting in accordance with section 1.446-1(e) may only request to change the method of accounting prospectively. *See* section 1.446-1(e)(3)(i); section 4.04, Rev. Proc. 84-74, 1984-2 C.B. 736, 741.

Under section 1.446-1(e)(2)(i) of the regulations, consent to change any method of accounting used by a taxpayer is a matter within the discretion of the Commissioner. The Commissioner, however, may prescribe other administrative procedures, subject to such limitations, terms and conditions as are deemed necessary to obtain the Commissioner's consent, to permit taxpayers to change their accounting method to a permissible method. *See* section 1.446-1(e)(3)(ii). Permission to change a taxpayer's method of accounting will not be granted unless the taxpayer and the Commissioner agree to the terms, conditions, and adjustments under which the change will be effected. *See* section 1.446-1(e)(3)(i).

The corporation under consideration in Rev. Rul. 70-539 adopted a method of accounting when it filed the second consecutive tax return in which it erroneously capitalized charges for interest, taxes, and other carrying charges associated with real estate. In that ruling, the corporation, which was required to obtain the Commissioner's consent to change the erroneous method, was permitted by the Service to change the method which capitalized charges to a method that treated the charges as current expenses by timely amending all prior returns reflecting the erroneous capitalization. However, upon reconsideration, the Service has determined that the special procedure under section 266 of the Code contained in Rev. Rul. 70-539 is not an appropriate departure from the general requirements of section 446(e) and the regulations. The Service has further determined that, in the circumstances described in Rev. Rul. 70-539, consent should be granted only for a prospective change of accounting method and only pursuant to an application for consent made under the generally applicable rules of section 1.446-1(e)(3)(i).

HOLDING

A taxpayer may not, without the Commissioner's consent, retroactively change from an erroneous to a permissible method of accounting by fil-

ing amended returns, even if the period for amending the return for the first year in which the erroneous method was used has not expired. Thus, a taxpayer that, for two or more consecutive tax years, has capitalized interest and other carrying charges under section 266 of the Code without making a valid election as required by applicable regulations has nonetheless adopted a method of accounting with respect to the interest and carrying charges. The taxpayer may not change that method of accounting by filing amended returns for those prior tax years. Instead, the taxpayer may only change the method of accounting with the consent of the Commissioner pursuant to section 1.446-1(e) of the regulations.

Consistent with the above, the Service will not follow *Gimbel Bros., Inc. v. United States*, 535 F.2d 14 (Ct. Cl. 1976), in which the court permitted the taxpayer to file amended returns for prior open years to effect a change in method of accounting for a material item.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 70-539 is revoked.

Rev. Rul. 75-56, 1975-1 C.B. 98, is modified to eliminate any inference that the statute of limitations must expire before the taxpayer has adopted a method of accounting under section 266 of the Code and, as modified, is revoked as obsolete.

Rev. Rul. 76-325, 1976-2 C.B. 88, is modified to delete the references to Rev. Rul. 70-539.

PROSPECTIVE APPLICATION

Under the authority contained in section 7805(b) of the Code, amended returns that were timely filed before April 30, 1990, the date this Revenue Ruling appears in the Internal Revenue Bulletin, to correct an impermissible capitalization method for expenses under section 266 with respect to all returns reflecting the impermissible method, will be accepted by the Service.

Section 274.—Disallowance of Certain Entertainment, etc., Expenses

26 CFR 1.274-5T: Substantiation requirements (temporary).

Self-employed individuals and employees may use the federal meal and incidental expense rate to compute the amount allowable as a deduction for business meal and incidental expenses paid or incurred while traveling away from home. See Rev. Proc. 90-15, page 476.

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26 CFR 1.274-5T: Substantiation requirements (temporary).

The revenue procedure provides rules under which the amount of ordinary and necessary expenses paid or incurred by an employee in driving an automobile in connection with the performance of services as an employee of the employer will be deemed substantiated under section 1.274-5T of the temporary regulations when a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. See Rev. Proc. 90-34, page 552.

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26 CFR 1.274-5T: Substantiation requirements (temporary).

Whether an employer is required to report on an employee's Form W-2, or to withhold and pay employment taxes on, amounts paid as a reimbursement or other expense allowance for daily transportation expenses incurred by the employee in going between the employee's residence and a temporary work location. See Rev. Rul. 90-23, page 28.

Section 277.—Deductions Incurred by Certain Membership Organizations in Transactions with Members

(Also Section 216; 1.216-1.)

Cooperative housing corporation; deductions allowed to tenant-stockholders. Section 277 of the Code applies to cooperative housing corporations, as defined in section 216(b), to determine the amount of net income the corporation derives from tenant-stockholders and nontenant-stockholders. The amount of deductions allowed to tenant-stockholders under section 216(a) may be affected by deductions disallowed to the corporation under section 277.

Rev. Rul. 90-36

ISSUES

(1) Does section 277 of the Internal Revenue Code apply to limit the deductions of a "cooperative housing corporation," as defined in section 216(b)(1)?

(2) If section 277 of the Code applies to a section 216 cooperative housing corporation, how is the cooperative housing corporation's taxable income determined?

(3) If section 277 of the Code applies to a section 216 cooperative housing corporation, what is the proper method of allocating the amount of the deductions disallowed under section 277 for purposes of determining the deductions allowed the cooperative housing corporation, as well as the deductions allowed the tenant-stockholders under section 216(a) ?

FACTS

COOP, a cooperative housing corporation described in section 216(b)(1) of the Code, owns an apartment building and the land on which it is situated. *COOP* has nine tenant-stockholders, all of whom reside in identical apartments in the building and together occupy 90 percent of the space in the building. *COOP* rents the remaining 10 percent of the space in the building to a commercial tenant. *COOP* and its tenant-stockholders file federal income tax returns on a calendar year basis and use the cash receipts and disbursements method of accounting.

In 1987, *COOP* (1) received $18,000 in income from the tenant-stockholders and $4,500 in rent from the commercial tenant, (2) incurred expenses of $13,500 for real estate taxes and interest on a mortgage and $9,000 for general operating expenses, and (3) determined the depreciation deduction on the building for 1987 to be $10,000.

LAW AND ANALYSIS—ISSUE (1).—APPLICATION OF SECTION 277.

Section 216(a) of the Code allows a deduction in the case of tenant-stockholders for amounts (not otherwise deductible) paid or accrued to a cooperative housing corporation within the taxable year, but only to the extent that such amounts represent the tenant-stockholder's proportionate share of the real estate taxes and interest allowable as deductions to the

corporation under sections 164 and 163, respectively.

Section 216(b)(1) of the Code defines "cooperative housing corporation" as a corporation (A) having one and only one class of stock outstanding, (B) each of the stockholders of which is entitled, solely because of ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by the corporation, (C) no stockholder of which is either conditionally or unconditionally entitled to receive any distribution not out of earnings and profits of the corporation (except upon a complete or partial liquidation thereof), and (D) 80 percent or more of the gross income of which for the taxable year in which the taxes and interest described in section 216(a) are paid or incurred is derived from the tenant-stockholders.

Section 277(a) of the Code provides that, in the case of a social club or other membership organization that is operated primarily to furnish services or goods to members and that is not exempt from taxation, deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members are allowed only to the extent of income derived during the year from members or transactions with members. If for any taxable year such deductions exceed such income, the excess is treated as a deduction attributable to furnishing services and other items to members paid or incurred in the succeeding taxable year.

Cooperative housing corporations described in section 216(b)(1) of the Code satisfy the three requirements set forth above for the application of section 277(a). First, a cooperative housing corporation is a membership organization. The tenant-stockholders of the corporation, who by virtue of their stock ownership are entitled to live in a house or apartment owned by the corporation, are the corporation's members. Second, a cooperative housing corporation furnishes housing and maintenance services to its tenant-stockholders. Because section 216(b)(1)(D) requires that 80 percent or more of the gross income of a cooperative housing corporation be derived from its tenant-stockholders, a cooperative housing corporation is operated primarily to furnish services to its stockholders. Finally, there is no provision exempting cooperative housing corporations described in section 216(b)(1) from federal income taxation.

In *Concord Consumers Housing Cooperative v. Commissioner*, 89 T.C. 105 (1987), section 277 of the Code was applied to a nonprofit, nonstock corporation providing housing to its members whose income was generally required not to exceed specified amounts. The application of section 277 by the court in Concord to the taxpayer corporation, whose members were entitled to occupy units in a building owned by the corporation, supports the application of section 277 to cooperative housing corporations described in section 216(b)(1), which similarly provide housing to their tenant-stockholders (members).

In addition, in connection with a 1976 amendment to section 216(c) of the Code, which expressly allows cooperative housing corporations to take depreciation deductions for property leased to their tenant-stockholders, the Senate Finance Committee indicated its understanding that section 277 is applicable to cooperative housing corporations described in section 216(b)(1) as follows:

> The committee does not believe that a clarification of the rules relating to the cooperative housing corporation's ability to take depreciation deductions with respect to property leased to tenant-stockholders will create tax avoidance possibilities because the provisions of existing law (sec. 277) generally prevent nonexempt membership organizations from offsetting nonmember income with losses from dealings with members.

S. Rep. No. 938, 94th Cong., 2d Sess. 398, 1976-3 (Vol. 3) C.B. 49, 436.

LAW AND ANALYSIS—ISSUE (2).—TAXABLE INCOME.

Section 277(a) of the Code limits the deductions attributable to furnishing services or items to members to the income received from the members. Thus, the expenses of *COOP* must be allocated between those attributable to furnishing services or items to its tenant-stockholders (members) and those attributable to furnishing services or items to its nontenant-stockholder (nonmember). Generally, the proper allocation of expenses under section 277(a) will depend on the facts and circumstances. In many cases, an allocation based on the relative fair market values of the space used by the tenant-stockholders and the nontenant-stockholders will be reasonable. Other methods of allocating the expenses, however, may be appropriate.

In this case, since 90 percent of the space in *COOP*'s building is used by its tenant-stockholders and 10 percent of the space in the building is used by a nontenant-stockholder, it is reasonable to attribute 90 percent of *COOP*'s $32,500 of total fixed expenses and general operating expenses to furnishing services and other items to its tenant-stockholders and 10 percent of such expenses to furnishing services and other items to its nontenant-stockholder renter. Thus, membership (tenant-stockholder) income and deductions for 1987 are as shown in Table 1:

REV. RUL. 90-36 TABLE 1

Membership income and deductions attributable to the portion (90 percent) of the building occupied by members

Membership income			$18,000
Less: Real estate taxes and interest	(90% of $13,500)	$12,150	
Other expenses	(90% of $ 9,000)	8,100	
Depreciation	(90% of $10,000)	9,000	
Total deductions			<$29,250>
Excess deductions			<$11,250>

Thus, in 1987 *COOP*'s deductions attributable to member use of its building exceed its income from members by $11,250. Under section 277 of the Code, $11,250 of *COOP*'s $29,250 of total deductions attributable to member use of the building will not be allowed in 1987, but must be carried forward to the succeeding taxable year as provided under section 277.

In 1987 *COOP*'s gross income attributable to nonmember use of its building exceeds its deductions attributable to nonmember use by $1,250. Thus, *COOP* is taxable on this $1,250 as illustrated in Table 2.

REV. RUL. 90-36 TABLE 2

Nonmembership income and deductions attributable to the portion (10 percent) of the building occupied by the commercial tenant

Nonmembership income		$4,500
Less: Real estate taxes and interest (10% of $13,500)	$1,350	
Other expenses (10% of $ 9,000)	900	
Depreciation (10% of $10,000)	1,000	
Total deductions		<$3,250>
Net nonmembership income		$1,250

LAW AND ANALYSIS—ISSUE (3).—ALLOCATION OF SECTION 277 DEDUCTION DISALLOWANCE.

The manner in which the disallowed $11,250 in membership deductions is allocated among *COOP*'s various membership expenses is important because section 216(a) of the Code generally allows the tenant-stockholders of a cooperative housing corporation to deduct amounts paid or accrued by them to the corporation representing their proportionate share of the real estate taxes and interest paid by the corporation. Specifically, section 216(a) allows tenant-stockholders to deduct such amounts to the extent the amounts represent "real estate taxes *allowable as a deduction to the corporation* under section 164" and "interest *allowable as a deduction to the corporation* under section 163." (Emphasis added).

The Senate Finance Committee, in commenting on the predecessor of section 216(a) of the Code, stated that the purpose of the real estate tax and interest pass-through deductions was "to place the tenant-stockholders of a cooperative apartment in the same position as the owner of a dwelling house so far as deductions for interest and taxes are concerned." S. Rep. No. 1631, 77th Cong., 2d Sess. 51 (1942), 1942-2 C.B. 504, 546.

To minimize the conflict between the application of the deduction disallowance provisions in section 277 of the Code to section 216 cooperative housing corporation deductions at the corporate level and the deduction pass-through objectives of section 216(a) at the tenant-stockholder level, amounts disallowed under section 277 will be deemed attributable first to expenses other than interest and real estate taxes (to the extent of such other expenses), and then to interest and real estate taxes if such attribution to the other expenses is used fully. Thus, amounts allowed in the first year (*i.e.*, amounts not disallowed under section 277) will be deemed attributable first to interest and real estate taxes, and then to expenses other than interest and real estate taxes. To determine the amount of each type of deduction allowed a cooperative housing corporation each year, a proportionate part of the amount disallowed under section 277 which is deemed attributable to a category of expenses is allowed to each type of expenses in the category.

Applying this approach to the facts of this revenue ruling, the $11,250 disallowance of membership deductions under section 277 of the Code for 1987 will be allocated first to depreciation and other expenses attributable to the portion of *COOP*'s building occupied by the tenant-stockholders. Because these expenses ($9,000 + $8,100 = $17,100) exceed the amount disallowed by section 277 ($11,250), *COOP*'s deductions in 1987 for real estate taxes and interest attributable to the portion of the building used by its members ($12,150) will be unaffected by section 277. Consequently, *COOP*'s tenant-stockholder deductions representing real estate taxes and interest are not reduced by section 277 in 1987.

Since the entire $11,250 disallowance is deemed attributable to *COOP*'s other expenses and depreciation deductions attributable to the portion of the building used by its members, only $5,850 of the total $17,100 of these expenses will be deductible in 1987. Of the $5,850 deductible in 1987, the other expense portion is $2,771.05 (8,100/17,100 x 5,850) and the depreciation portion is $3,078.95 (9,000/17,100 x 5,850). Of the $11,250 disallowed portion of these expenses which is carried over to 1988, the other expense portion is $5,328.95 (8,100/17,100 x 11,250) and the depreciation portion is $5,921.05 (9,000/17,100 x 11,250).

HOLDINGS

(1) Section 277 of the Code applies to limit the deductions of cooperative housing corporations, as defined in section 216(b)(1).

(2) For purposes of determining the cooperative housing corporation's taxable income, in this case it is reasonable to attribute the fixed expenses and general operating expenses paid or incurred by the corporation on a space-used basis between tenant-stockholder gross income and nontenant-stockholder gross income. Such attributed expenses are then subtracted from the respective gross income amounts to determine the corporation's taxable income.

(3) For purposes of determining the deductions allowed the cooperative housing corporation and the deductions allowed the tenant-shareholders under section 216(a) for their proportionate shares of the interest and real estate taxes paid or accrued by the cooperative housing

corporation, any deduction disallowed under section 277 of the Code is attributed first to expenses other than interest and real estate taxes (to the extent of such other expenses) and then to interest and real estate taxes if such attribution to the other expenses is used fully. For purposes of determining the amount of each type of deduction allowed a cooperative housing corporation each year, a proportionate part of the amount disallowed under section 277 which is deemed attributable to a category of expenses is allocated to each type of expense in the category.

Section 280C.—Certain Expenses for Which Credits Are Allowable

26 CFR 1.280C-4: Credit for increasing research activities.

T.D. 8282

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Election of Reduced Research Credit

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final income tax regulations relating to the manner of making an election under section 280C(c)(3) of the Internal Revenue Code, as amended by section 7814(e)(2)(A) of the Revenue Reconciliation Act of 1989. This election enables a taxpayer to claim a reduced income tax credit for increasing research activities and thereby avoid a reduction of the section 174 deduction for research and experimental expenditures. These regulations provide guidance to persons making the election.

EFFECTIVE DATE: These regulations are effective for taxable years beginning after December 31, 1988.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

This regulation is being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in this regulation has been reviewed and, pending receipt of public comments, approved by the Office of Management and Budget (OMB) under control number 1545-1155.

Comments concerning the collection of information and the accuracy of estimated average annual burden and suggestions for reducing this burden should be directed to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer T:FP, Washington, D.C. 20224.

The collection of information in this regulation is in §1.280C-4. This information is required by the Internal Revenue Service to compute the federal income tax liability of taxpayers. The likely respondents/recordkeepers are business and other for-profit taxpayers.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents/recordkeepers may require greater or less time, depending on their particular circumstances.

The estimated total annual reporting and/or recordkeeping burden is 65 hours.

The estimated average annual burden per respondent/recordkeeper is .3 hours to complete the election.

The estimated number of respondents/recordkeepers making the election described in this regulation is 220.

The estimated annual frequency of responses (for reporting requirements only) is one.

Background

In the Technical and Miscellaneous Revenue Act of 1988 (the 1988 Act), Congress extended the termination date of section 41 of the Code, relating to the income tax credit for increasing research activities. At the same time, Congress added a new paragraph (c) to section 280C, effective for taxable years beginning after December 31, 1988. Paragraphs (1) and (2) of new section 280(c) require taxpayers to reduce the amount of qualified research expenses otherwise allowable as a deduction under section 174 by an amount equal to a certain percentage of the credit determined under section 41(a). For taxable years beginning in 1989, this "deduction disallowance" equals 50 percent of the credit determined under section 41(a). For taxable years beginning after December 31, 1989, section 7110(c) of the Revenue Reconciliation Act of 1989 (the 1989 Act) increases the deduction disallowance to 100 percent of the credit determined under section 41(a).

The 1988 Act also added a new section 41(h) to the Code, which permitted a taxpayer to avoid the section 174 deduction disallowance for a taxable year by electing to forego entirely the taxpayer's section 41(a) credit for the year. Section 7814(e) of the 1989 Act modified this election by retroactively repealing section 41(h), and adding new section 280C(c)(3). New section 280C(c)(3) reduces an electing taxpayer's section 41(a) credit only by an amount equal to the taxes saved from avoiding the deduction disallowance.

Specifically, under new section 280C(c)(3)(C), a taxpayer is permitted to avoid the deduction disallowance provisions of section 280C(c)(1) and (2) by electing to reduce its section 41(a) credit by the amount of tax saved (assuming the highest corporate tax rate) by not making a reduction in the amount allowable as a deduction under section 174. (See section 280C(c)(3) as amended by sections 7814(e) and 7110(c)(1) of the 1989 Act.) Subparagraph (B) of section 280C(c)(3) provides the method for computing the reduced credit for taxpayers making this election. The taxpayer must first compute its section 41(a) credit without regard to section 280C(c)(3), and then multiply this amount (or 50 percent of this amount for taxable years beginning before January 1, 1990) by the maximum rate of tax in section 11(b)(1) of the Code. The product of this multiplication is then subtracted from the full amount of the section 41(a) credit. The remainder is the amount of credit allowed.

Section 280C(c)(3)(C) provides that the election shall be made not later

than the time for filing the federal tax return (including extensions) for the taxable year in which the election is made. The election shall be made on such return, and shall be made in such manner as the Secretary of the Treasury may prescribe. The election for a taxable year, once made, shall be irrevocable. In the case of a taxable year for which the time for filing the return of tax (including extensions) is on or before the date which is 75 days after the enactment of the 1989 Act (that date is March 4, 1990), section 7814(e)(2)(B) of the 1989 Act provides that the election for that taxable year may be made at any time before the date which is 75 days after the date of enactment of the 1989 Act, in the manner prescribed by the Secretary of the Treasury. This document contains regulations prescribing the manner for making the election.

Explanation of Provisions

Regulations §1.280C–4 provides that the election under section 280C(c)(3) shall be made by claiming the reduced research credit under section 41(a) determined by the method provided in section 280C(c)(3)(B) on an original return, filed at any time on or before the due date (including extensions) for filing the income tax return for such year.

Except as provided below, for a taxable year described in section 7814(e)(2)(B) of the 1989 Act (that is, a taxable year beginning after December 31, 1988, for which the time for filing the return (including extensions) is on or before March 4, 1990), the election shall be made by claiming the reduced credit on an original or amended return filed on or before March 3, 1990.

A taxpayer will be treated as having made the election under section 280C(c)(3) if (1) prior to December 19, 1989 (the enactment date of the 1989 Act) the taxpayer made an election for a taxable year described in section 7814(e)(2)(B) of the 1989 Act under former section 41(h) (by not claiming any section 41(a) credit), and (2) the taxpayer has not filed an amended return on or before March 3, 1990, claiming the full credit allowable under section 41(a). In effect, taxpayers that elected under former section 41(h) to forego all of the credit in favor of a full deduction will be treated as having elected to forego a part of the credit under section 280C(c)(3). If a taxpayer who made the section 41(h) election does not wish to be treated as having made an election under section 280C(c)(3), the taxpayer must file an amended return for such taxable year on or before March 3, 1990, claiming the full section 41(a) credit. If a taxpayer is treated as having made the section 280C(c)(3) election in the taxable year described above, the provisions of section 280C(c)(1) and (2) shall not apply in such taxable year.

In order to obtain the benefit of the reduced section 41(a) credit, a taxpayer who is treated as having made the section 280C(c)(3) election must claim the reduced section 41(a) credit determined by the method provided in section 280C(c)(3)(B) (as opposed to claiming no credit under former section 41(h)) on an amended return filed at any time before the expiration of the period prescribed in section 6511 of the Code for filing a claim for credit or refund of the tax imposed by chapter 1 of the Code.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Part 1 and Part 602 are amended as follows:

PART 1—[AMENDED]

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. *** Section 1.280C–4 also issued under 26 U.S.C. 280C(c) and 103 Stat. 2413. ***

Par. 2. A new §1.280C–4 is added immediately after §1.280C–3 to read as follows:

§1.280C–4 Credit for increasing research activities.

(a) *In general.* The election under section 280C(c)(3) to have the provisions of section 280C(c)(1) and (2) not apply shall be made by claiming the reduced credit under section 41(a) determined by the method provided in section 280C(c)(3)(B) on an original return for the taxable year, filed at any time on or before the due date (including extensions) for filing the income tax return for such year. An election, once made for any taxable year, shall be irrevocable for that taxable year.

(b) *Transition rule*—(1) *In general.* In the case of a taxable year beginning after December 31, 1988, for which the due date (including extensions) for filing the return is on or before March 4, 1990, the election under section 280C(c)(3) shall be made by claiming the reduced credit under section 41(a) determined by the method provided in section 280C(c)(3)(B) on an original or amended return for such taxable year filed on or before March 3, 1990.

(2) *Taxpayers who made an election under former section 41(h).* If a taxpayer—

(i) Prior to December 19, 1989, made an election for a taxable year described in paragraph (b)(1) of this section under section 41(h) (as it existed before it was repealed by section 7814(e) of the Revenue Reconciliation Act of 1989) by not claiming any credit allowable under section 41(a); and

(ii) Has not filed an amended return on or before March 3, 1990, claiming the full credit allowable under section 41(a), the taxpayer will be treated as having made an election under section 280C(c)(3). Therefore, the provisions of section 280C(c)(1) and (2) shall not apply in such taxable year. However, in order to obtain the benefit of the reduced credit under section 41(a) determined by the method provided in section 280C(c)(3)(B), such a taxpayer must claim the reduced credit on an amended return filed before the expiration of the period prescribed in section 6511 for filing a claim for credit or refund of the tax imposed by chapter 1 of the Code.

(c) *Effective date.* The provisions of this section are effective for taxable years beginning after December 31, 1988.

PART 602—[AMENDED]

Par. 3. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. Section 602.101(c) is amended by inserting in the appropriate place in the table "§1.280C-4 . . . 1545-1155".

This Treasury decision merely prescribes the manner of making the election under section 280C(c)(3). For this reason, it is found unnecessary to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved January 16, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 23, 1990, 8:45 a.m., and published in the issue of the Federal Register for January 24, 1990, 55 F.R. 2374)

Section 280F.—Limitation on Investment Tax Credit and Depreciation for Luxury Automobiles: Limitation Where Certain Property Used for Personal Purposes

26 CFR 1.280F-2T: Limitations on recovery deductions and the investment tax credit for certain passenger automobiles (temporary).

Limitations on depreciation deductions for passenger automobiles that are first placed in service during 1990 and table for use in determining the amounts included in income by lessees of passenger automobiles that are first leased during calendar year 1990. See Rev. Proc. 90-22, page 504.

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26 CFR 1.280F-7T: Property leased after December 31, 1986 (temporary).

T.D. 8298

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Leased Passenger Automobiles—Tables for Determining the Amount Included in Lessee's Income

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations providing for adjustments in the table used to determine the amount included in the income of a lessee of a passenger automobile. The tax law applicable to automobiles placed in service after 1988 requires annual adjustments in the table to reflect automobile price inflation. The temporary regulations affect persons who lease passenger automobiles after December 31, 1986.

EFFECTIVE DATE: These regulations are effective after December 31, 1986, and apply to passenger automobiles that are first leased after December 31, 1986.

SUPPLEMENTARY INFORMATION:

Need for Temporary Regulations

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. It is therefore found impractical and contrary to the public interest to issue this Treasury decision with notice and public procedure under section 553(b) of Title 5 of the United States Code or subject to the effective date limitations of section 553(d) of Title 5, United States Code.

Explanation of Provisions

Section 280F(c) of the Code requires a reduction in the deduction allowed to the lessee of an automobile. This reduction must be substantially equivalent to the limitations on the depreciation deductions imposed on owners of automobiles. For automobiles first leased in calendar years 1987 and 1988, this reduction is accomplished by including in gross income an amount determined by applying a formula to the amount obtained from the table in §1.280F-7T(a)(2)(iv) of the temporary Income Tax Regulations published in the Federal Register of August 9, 1988, 53 Fed. Reg. 29880 [T.D. 8218, 1988-2 C.B. 40].

In the case of automobiles placed in service after 1988, section 280F(d)(7) provides that the dollar amount allowable as a depreciation deduction is increased by an automobile price inflation adjustment. Because of the changes in the depreciation limitations attributable to the required automobile price inflation adjustment, the inclusion amounts determined by using the table in the regulations are not substantially equivalent to the limitations on the depreciation deductions applicable to automobiles placed in service after 1988. Thus, the temporary regulations provide that the table in §280F-7T(a) applies only to automobiles first leased in 1987 or 1988, and authorize the future issuance of a new table whenever an automobile price inflation adjustment changes the depreciation limitations. The table will be published in the Internal Revenue Bulletin.

Lessees should compute the inclusion amount in the manner prescribed in §1.280F-7T(a), using the table applicable to the calendar year when the automobile is first leased. Thus, for an automobile first leased in the 1987 or 1988 calendar year, the lessee should determine the amount to be added to gross income by using the table included in §1.280F-7T(a)(2) of the regulations. For an automobile first leased in a later calendar year, the inclusion amount is computed by using a table published in the Internal Revenue Bulletin.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of the proposed rulemaking for the regulations was submitted to the administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of Amendments to the Regulations

For the reasons set out in the preamble, Title 26, Chapter I, Part 1 of the Code of Federal Regulations is amended as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805 *** Section 1.280F-7T also issued under 26 U.S.C. 280F(c). ***

Par. 2. Section 1.280-7T is amended by revising paragraph (a)(2)(i) and (ii) and the text preceding the table in paragraph (a)(2)(iv) and by adding a heading to the table in paragraph (a)(2)(iv) and a new paragraph (a)(2)(v). The revised and added provisions read as follows:

§1.280F-7T Property leased after December 31, 1986 (Temporary).

(a) ***

(2) ***

(i) For the appropriate range of fair market values in the applicable table, select the dollar amount from the column for the taxable year in which the automobile is used under the lease (but for the last taxable year during any lease that does not begin and end in the same taxable year, use the dollar amount for the *preceding* taxable year).

(ii) Prorate the dollar amount for the number of days of the lease term included in the taxable year.

* * * * *

(iv) The following table is the applicable table in the case of a passenger automobile leased after December 31, 1986, and before January 1, 1989:

DOLLAR AMOUNTS FOR AUTOMOBILES WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 1987 OR 1988

* * * * *

(v) The applicable table in the case of a passenger automobile first leased after December 31, 1988, will be contained in a revenue ruling or revenue procedure published in the Internal Revenue Bulletin.

* * * * *

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved March 14, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on April 11, 1990, 8:45 a.m., and published in the issue of the Federal Register for April 12, 1990, 55 F.R. 13769)

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26 CFR 1.280F-7T(a): Inclusions in income of lessees of passenger automobiles leased after December 31, 1986 (temporary).

Limitations on depreciation deductions for passenger automobiles that are first placed in service during 1990 and table for use in determining the amounts included in income by lessees of passenger automobiles that are first leased during calendar year 1990. See Rev. Proc. 90-22, page 504.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of January 1990. See Rev. Rul. 90-1, page 155.

Federal short-term, mid-term, and long-term rates are set forth for the month of February 1990. See Rev. Rul. 90-12, page 156.

Federal short-term, mid-term, and long-term rates are set forth for the month of March 1990. See Rev. Rul. 90-22, page 158.

Federal short-term, mid-term, and long-term rates are set forth for the month of April 1990. See Rev. Rul. 90-28, page 159.

Federal short-term, mid-term, and long-term rates are set forth for the month of May 1990. See Rev. Rul. 90-41, page 161.

Federal short-term, mid-term, and long-term rates are set forth for the month of June 1990. See Rev. Rul. 90-48, page 162.

Part XI.—Special Rules Relating to Corporate Preference Items

Section 291.—Special Rules Relating to Corporate Preference Items

Guidelines are set forth regarding the disallowance, under section 265(b) of the Code, of interest expense allocable to tax-exempt obligations held by financial institutions. See Rev. Rul. 90-44, page 54.

Subchapter C.—Corporation Distributions and Adjustments

Part I.—Distributions By Corporations

Subpart A.—Effects on Recipients

Section 301.—Distributions of Property

26 CFR 1.301-1: Distribution of money and other property.

A corporation's adoption of a "poison pill" plan does not cause any taxpayer to realize gross income. See Rev. Rul. 90-11, page 10.

Section 302.—Distributions in Redemption of Stock

26 CFR 1.302-1: General.
(Also Section 346; 1.346-1.)

Partial liquidation; pro rata distribution and shareholder surrender of stock. A redeemed shareholder need not surrender stock in order for a pro rata distribution in partial liquidation to qualify as a redemption under section 302(b)(4) and (e) of the Code. Rev. Ruls. 79-257 and 81-3 obsoleted.

Rev. Rul. 90-13

ISSUE

Must shareholders surrender stock in the distributing corporation to qualify for partial liquidation treatment under section 302(b)(4) and (e) of the Internal Revenue Code, if the distribution is pro rata?

FACTS

Corporation *X* operated two divisions of equal size and had one class of stock outstanding, which was owned by individuals *A* and *B*. There were no outstanding rights, such as warrants, options, convertible securities, shareholder agreements or rights of first refusal, affecting the stock of *X*.

Pursuant to a plan of partial liquidation, *X* sold one of its divisions to an unrelated party for cash and distributed the cash proceeds of the sale to *A* and *B* pro rata. *A* and *B* did not surrender any stock in exchange for the cash distributed by *X*.

Except for the question as to whether there must be a surrender of stock by the shareholders, the transaction qualifies as a partial liquidation under section 302(b)(4) and (e) of the Code.

LAW AND ANALYSIS

Section 331(a)(2) of the Code, prior to the enactment of the Tax Equity

and Fiscal Responsibility Act of 1982 (TEFRA), provided that amounts distributed in partial liquidation of a corporation (as defined in pre-TEFRA section 346) were treated by a shareholder as payment in exchange for stock.

Section 346(a)(2) of the Code, prior to the enactment of TEFRA, provided that a distribution was treated as in partial liquidation of a corporation if the distribution was not "essentially equivalent to a dividend," was in redemption of a part of the stock of the corporation pursuant to a plan, and occurred within the tax year in which the plan was adopted or within the succeeding tax year. Before amendment by TEFRA, section 346(B) provided a safe-harbor rule under which the "not essentially equivalent to a dividend" requirement of former section 346(a)(2) was considered satisfied.

TEFRA transferred the treatment of distributions in partial liquidation from former section 331(a)(2) of the Code to section 302(b)(4), added by TEFRA, and the definition of the term "partial liquidation" from former section 346(a)(2) and (b) to section 302(e), also added by TEFRA. Section 222 of TEFRA, 1982-2 C.B. 462, 498-500.

Section 302(a) of the Code provides that, if a corporation redeems its stock (within the meaning of section 317(b)), and if section 302(b) applies, the redemption is treated as a distribution in part or full payment in exchange for stock.

Section 317(b) of the Code provides that, for purposes of certain sections, including section 302, stock is treated as redeemed by a corporation if the corporation acquires its stock from a shareholder in exchange for property.

Section 302(b)(4) of the Code provides that section 302(a) applies to a distribution if the distribution is both (A) in redemption of stock held by a shareholder who is not a corporation, and (B) in partial liquidation of the distributing corporation.

Section 302(e)(1) of the Code provides that, for purposes of section 302(b)(4), a distribution is treated as in partial liquidation of a corporation if it is not "essentially equivalent to a dividend" (determined at the corporate level rather than at the shareholder level), is pursuant to a plan, and occurs within the tax year in which the plan is adopted or within the succeeding tax year. Section 302(e)(2) and (3) provides a safe-harbor rule similar to the safe-harbor rule in former section 346(b).

Under section 302(b)(4)(A) and (B) of the Code, respectively, two requirements for partial liquidation treatment are that (1) stock be redeemed and (2) the redemption be in partial liquidation within the meaning of section 302(e). The second requirement can be satisfied (as the facts here indicate it has been satisfied) irrespective of an actual stock surrender because under section 302(b)(4)(B) and (e) this requirement is tested at the corporate level, not the shareholder level, and is not concerned with stock ownership.

However, the first requirement—that stock be redeemed—is tested at the shareholder level. Moreover, the reference to section 317(b) of the Code in section 302(a) raises the question whether an actual surrender of stock is required for a transaction to be treated as a partial liquidation under section 302(b)(4).

Rev. Rul. 79-257, 1979-2 C.B. 136, concerning facts similar to the facts here, held that an actual surrender of stock by a sole shareholder was not required in partial liquidation under pre-TEFRA section 346 of the Code. A surrender of stock was seen as a meaningless gesture because the sole shareholder's interest in the corporation would have remained unchanged. In Rev. Rul. 81-3, 1981-1 C.B. 125, the Internal Revenue Service extended this holding to include all pro rata distributions in connection with partial liquidations under former section 346. *But see* Rev. Proc. 89-3, 1989-1 C.B. 761, 766, Section 5.07.

The TEFRA conference report, in explaining the treatment of partial liquidations, states:

> Under present law, a distribution in partial liquidation may take place without an actual surrender of stock by the shareholders (*Fowler Hosiery Co. v. Commissioner*), 301 F.2d 394 (7th Cir. 1962). A constructive redemption of stock is deemed to occur in such transactions (Rev. Rul. 81-3, 1981-1 C.B. 125). The conferees intend that the treatment of partial liquidations under present law section 346(a)(2) and (b) is to continue for such transactions under new section 302(e).

H.R. Conf. Rep. No. 760, 97th Cong., 2nd Sess. 530 (1982), 1982-2 C.B. 600, 628-29.

Section 317(b) of the Code requires a corporation to acquire its stock in order for a transaction to be treated as a redemption under section 302. As indicated by the above-quoted committee report, a deemed surrender of stock in a pro rata distribution satisfies the redemption requirement of sections 302 and 317(b) in partial liquidation transactions, just as a deemed surrender satisfied the redemption requirement under pre-TEFRA section 346(a)(2). In the situation presented by this revenue ruling, the requirement of sections 302 and 317(b) is met by a deemed surrender of stock.

HOLDING

The pro rata distribution by *X* to its shareholders, individuals *A* and *B*, qualifies as a distribution in redemption of stock held by *A* and *B* in partial liquidation of *X* under section 302(b)(4) and (e) of the Code, even though the shareholders did not surrender any of their stock.

See Rev. Rul. 77-245, 1977-2 C.B. 105, for computation of the tax consequences to *A* and *B* resulting from the partial liquidation.

EFFECT ON OTHER REVENUE RULINGS

Rev. Ruls. 81-3 and 79-257 are obsoleted.

Subpart B.—Effects on Corporations

Section 337.—Nonrecognition for Property Distributed to Parent in Complete Liquidation of Subsidiary

26 CFR 1.337(d)-1T: Transitional loss limitation rule (temporary).
(Also Section 1502.)

T.D. 8294

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Consolidated Return Regulations—Special Rules Relating to Dispositions and Deconsolidations of Subsidiary Stock

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations under sections 337(d) and 1502 that implement the repeal of the *General Utilities* doctrine and eliminate duplication of loss with respect to members of affiliated groups filing consolidated returns. The regulations apply on a disposition or deconsolidation of stock of a subsidiary of the group. The text of the temporary regulations set forth in this document also serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in *** [CO-78-87, page 558, this Bulletin].

DATES: The regulations in this document are effective March 9, 1990. Section 1.337(d)-1T applies with respect to dispositions occurring after January 6, 1987, of stock of a corporation that became a member of an affiliated group after January 6, 1987, if the disposition is not subject to §1.1502-20T.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in these regulations have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under control number 1545-1160. The estimated average annual burden per respondent varies from 1 1/2 to 2 1/2 hours, depending on individual circumstances, with an estimated average of 2 hours.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents may require greater or less time, depending on their particular circumstances.

For further information concerning these collections of information, and where to submit comments on these collections of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referenced notice of proposed rulemaking published in *** [CO-78-87, page 558, this Bulletin].

A. Introduction

This document adds temporary regulations §§1.1502-20T, 1.1502-1T, and 1.337(d)-1T to Part 1 of Title 26 of the Code of Federal Regulations, and adds cross-references to §§1.1502-12, 1.1502-32, 1.1502-33 and 1.1502-79. The temporary regulations added by this document will remain in effect until superseded by later temporary or final regulations relating to these matters.

Temporary regulations §1.1502-20T adds to the consolidated return regulations a general rule that disallows all losses on the disposition by a member of stock of a subsidiary when both are members of the same affiliated group filing consolidated returns (the "loss disallowance rule"). The regulations also provide a number of related rules to ensure the proper application of the loss disallowance rule (*e.g.*, a "basis reduction" rule that applies on deconsolidation of stock of a subsidiary and an "anti-stuffing" rule). Also provided is a rule that permits reattribution of a subsidiary's (or lower-tier subsidiary's) losses to the common parent to the extent, if any, of the loss disallowed to the selling member on the sale of the subsidiary's stock. These rules generally apply with respect to dispositions occurring on or after March 9, 1990.

Temporary regulations §1.337(d)-1T adds a transition rule that generally disallows loss on the disposition by a member of a subsidiary's stock if the subsidiary became a member of the group after January 6, 1987, and if the disposition is not subject to §1.1502-20T, but permits the loss to the extent the selling member establishes that the loss is not attributable to the recognition of "built-in gain" on the disposition of assets owned, directly or indirectly, by the subsidiary.

These temporary regulations implement Notice 87-14, 1987-1 C.B. 445, in which the Internal Revenue Service announced its intention to publish regulations that would, in effect, prevent utilization of the investment adjustment rules of §§1.1502-32 and 1.1502-33(c) (the "investment adjustment rules") to circumvent the repeal of the *General Utilities* doctrine by the Tax Reform Act of 1986 (the "1986 Act") [Pub. L. 99-514, 1986-3 C.B. (Vol. 1) 1]. The loss disallowance rule of §1.1502-20T also addresses another problem by preventing a subsidiary's losses from being duplicated as investment losses of the parent when the parent disposes of the subsidiary's stock.

B. The Investment Adjustment Rules and General Utilities Repeal

1. The Investment Adjustment Rules

The investment adjustment rules are designed to prevent income or loss that has been recognized at the subsidiary level from again being recognized as investment gain or loss by the subsidiary's parent upon disposition of the subsidiary's stock. This is generally accomplished by requiring positive or negative adjustments to the basis of the subsidiary's stock owned by members of the group to reflect the increase or decrease in value of the subsidiary resulting from income or loss that has been taken into account by the group.

Example 1. Corporation P forms corporation S by transferring $100 cash to S in exchange for all of S's stock. P and S elect to file consolidated returns. S earns $50 during the next 5 years, which is included in the consolidated taxable income of the P group. Under the investment adjustment rules, P's basis in its S stock is increased by $50. Thus, if P sells S for $150 at the end of Year 5, the P group does not recognize any further gain or loss.

Without the increase to the basis of the S stock provided under the investment adjustment rules, the P group would, in effect, recognize S's $50 of income twice, once when it was earned by S and again as an investment gain when P sold the S stock.

2. The General Utilities Doctrine

In general, income earned by a corporation is taxed twice, once to the corporation when the income is earned and a second time to the corporation's shareholders when the earnings are distributed. For many years, the *General Utilities* doctrine

provided an exception to this two-level system of taxation. Under this doctrine, which takes its name from *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200 (1935), corporations were not required to recognize gain or loss when they distributed appreciated or depreciated property to their shareholders, either in liquidation or simply as a part of ongoing operations (*e.g.*, as a dividend), or when they sold the property and distributed the proceeds in liquidation. Subject to certain exceptions, this doctrine permitted the permanent elimination of corporate-level tax on the disposition of appreciated assets because the transferee received a fair market value basis in the assets as they left corporate solution, despite the fact that no corporate-level tax had been paid on the appreciation. The *General Utilities* doctrine was codified in sections 311, 336 and 337 of the Internal Revenue Code of 1954.

3. Repeal of the General Utilities Doctrine

The scope of the *General Utilities* doctrine was restricted by a series of amendments beginning in 1969 (relating generally to non-liquidating distributions governed by section 311) and the doctrine was ultimately repealed by the 1986 Act, which amended sections 336 and 337 to require, with limited exceptions, that corporations recognize gain or loss when property is distributed in liquidation or sold in connection with a liquidation.

The legislative history of the 1986 Act indicates that the principal reason for the repeal of the *General Utilities* doctrine was that it tended to undermine the corporate income tax because "[u]nder normally applicable tax principles, nonrecognition of gain is available only if the transferee takes a carryover basis in the transferred property, thus assuring that a tax will eventually be collected on the appreciation." H.R. Rep. No. 99-426, 99th Cong., 1st Sess. 282 (1985). See also H.R. Conf. Rep. No. 99-841, 99th Cong., 2d Sess. II-202 (1986), which states as the rationale for continuing tax-free treatment under section 332 for liquidating distributions of assets of controlled subsidiaries that, because the carryover basis rules apply, "the corporate level tax will be paid if the distributed property is disposed of by the recipient corporation to a person outside of the group."

Thus, it is clear that the principal purpose for the repeal of the *General Utilities* doctrine was to require the payment of a corporate-level tax in a transaction that results in a stepped-up basis to the new owner.

4. Results Under Investment Adjustment Rules Conflict with General Utilities Repeal in Some Cases

The investment adjustment rules reflect the application of the *General Utilities* doctrine and can therefore be used to obtain a stepped-up basis in corporate assets without the payment of corporate-level tax.

Example 2. Corporation S has one asset with a basis of $0 and a value of $100. Corporation P buys all the stock of S for $100 and P and S elect to file consolidated returns. S then sells the asset for $100 and recognizes gain of $100. Under the investment adjustment rules, P's basis in the stock of S is increased to $200 because the sale of the asset generated $100 of earnings and profits to S. This basis increase permits P to recognize a loss of $100 if P sells the S stock, thus offsetting the gain on the sale of the asset.

The increase in the basis of P's stock in S is inconsistent with the repeal of the *General Utilities* doctrine. The failure to require the P group to fully account for S's recognized built-in gain in effect permits the elimination of corporate-level tax on this gain, because the increase in P's basis for the S stock is attributable to S's recognition of built-in gain (gain already reflected in P's cost basis for the S stock) and not to earnings that increase S's value. Moreover, P's loss does not represent an economic loss of either P or S.

Although the taxpayer that sold the S stock to P may have recognized gain on the sale that corresponded to S's built-in gain, if the taxpayer was not a corporation, no corporate-level tax would have been paid in connection with the basis step up. However, even if the seller was a corporation, transferee taxpayers generally are not given credit for tax on gain recognized by unrelated transferor taxpayers.

The problem is not limited to dispositions of built-in gain assets, but also arises when built-in gain assets are consumed.

Example 3. The facts are the same as in Example 2, except that S uses the asset in business operations rather than selling it. The asset earns $20 and declines in value by $20 in each year over a 5-year period. As in Example 2, P's basis in the stock of S is increased by the earnings to $200, but the value of S remains $100 and P may recognize a loss of $100 if P sells the S stock.

In Examples 2 and 3, disallowing P's $100 loss eliminates the possibility that investment adjustments caused by S's recognition of built-in gain, whether from dispositions or operations, will result in elimination of the gain. Disallowing P's loss therefore gives effect to *General Utilities* repeal by assuring that a corporate-level tax will be imposed on S's recognized built-in gain.

C. Loss Duplication

In addition to resolving the problems created under the investment adjustment rules by *General Utilities* repeal, the loss disallowance rule also resolves a problem involving the duplication of losses. Under current rules, there are several situations in which a loss may be duplicated by a parent and its subsidiary.

Example 4. Corporation P forms subsidiary S with a contribution of $100 and P and S elect to file consolidated returns. S has an operating loss of $60. The group is unable to use the loss and it becomes a consolidated net operating loss carryover attributable to S. P sells S for $40. A special adjustment under §1.1502-32(b)(1)(ii) prevents S's unused $60 loss from reducing P's $100 basis in its S stock. Accordingly, P recognizes a $60 loss on the sale of S. P's $60 loss reflects P's economic loss on its investment in S (P contributed $100 to S and sold it for $40 without using S's inside loss on its consolidated return). S's loss carryover is apportioned to S for use after leaving the P group (subject to any limitation imposed by sec-

tion 382 or otherwise). P's loss on the sale of the S stock is therefore duplicated when S uses its loss after leaving the P group.

This duplication may be offset at a later date. If S uses its loss carryover in the consolidated return of another group (P1), the use reduces the basis of S's stock in the hands of P1 under §1.1502-32(b)(2)(ii). As a result of this reduction, there is a potential offsetting gain if P1 sells the S stock. However, in some circumstances P1 may use self-help measures to postpone recognition of the gain indefinitely (by retaining the S stock) or to avoid recognition of the gain altogether (by liquidating S or by selling the S stock and electing deemed asset sale treatment under section 338(h)(10)).

Loss duplication also occurs in Example 4 if S uses the $100 contributed by P to purchase an asset and the asset declines in value by $60. Because the loss is unrealized, it is not reflected in S's earnings and profits and P's basis in its S stock therefore remains $100. When P sells the S stock to P1, it recognizes a $60 loss. S later recognizes a loss of $60 when it sells the built-in loss asset. Although P1 must reduce the basis of S's stock when the loss is used, establishing the potential for an offsetting gain if P1 sells the stock, once again P1 can use self-help measures to postpone or totally avoid recognizing the gain by retaining the S stock indefinitely, by liquidating S or by selling the S stock in a transaction in which section 338(h)(10) is elected.

Duplication of gain can also occur under the current rules. If an asset of S simply increases in value by $60, P will recognize $60 of gain when it sells the S stock to P1 and S will recognize $60 of gain when it subsequently sells the asset. When S sells the asset, P1's basis in its S stock is increased by $60, thereby establishing the potential for an offsetting loss if P1 sells the S stock. In contrast to the two loss duplication situations, however, P1 has no incentive to avoid recognizing this loss because recognizing the loss eliminates gain duplication.

As noted, duplication of gain and loss can be avoided under the current rules if S's assets, rather than its stock, are sold (either by S or by P after a liquidation of S) or if the P group and P1 elect deemed asset sale treatment under section 338(h)(10). Because the structure of many transactions is generally elective as between stock sales and asset sales (or stock sales treated as asset sales), taxpayers will often be able to use these self-help measures to avoid duplication of gain, but will avoid using them in order to preserve duplication of loss. Disallowing loss on P's sale of the S stock eliminates this selective duplication of loss.

D. Approaches Not Adopted

Notice 87-14 announced that the investment adjustment rules would be amended to "prevent recognition of losses that are attributable to the subsidiary's recognition of built-in gains." Implementation of Notice 87-14 requires either a rule that would eliminate positive basis adjustments of the type illustrated in Examples 2 and 3 or a rule that would disallow losses resulting from such adjustments.

Following the publication of Notice 87-14, the Treasury Department and the Service undertook an intensive study of the various methods for reconciling the results under the consolidated return regulations with the intent of Congress in repealing the *General Utilities* doctrine. The study also took into account the effect of each method on the problem of loss duplication.

1. Tracing

The most accurate method of eliminating losses resulting from the recognition of built-in gain would be to eliminate positive basis adjustments under the investment adjustment rules when those adjustments are from earnings attributable to the recognition of built-in gain and to reduce stock basis if a distribution of current earnings and profits is attributable to such gain. This method is commonly referred to as "tracing."

The theoretical accuracy that would be achieved by tracing is undermined, however, by the fact that it would impose tremendous administrative burdens on both taxpayers and the Service. In order to determine the extent of built-in gain or loss in each asset, all assets and liabilities of an acquired subsidiary (and of any lower tier subsidiaries) would have to be appraised at the time the subsidiary's stock is acquired. Furthermore, each asset with built-in gain or loss would have to be traced to determine the extent to which the built-in gain or loss was recognized while the group held the stock of the subsidiary. Although appraisals and tracing might be relatively simple in a few cases (*e.g.*, when the acquired subsidiary has only one asset or relatively few assets), most cases would present extremely difficult problems because of the number and nature of the assets held by the acquired subsidiary.

Tracing involves other burdens in addition to requiring taxpayers to appraise assets and trace their disposition. For example, by using up or wearing out an asset in the process of earning income, the subsidiary is, in effect, disposing of the asset in exchange for the income. Accordingly, if the subsidiary, rather than selling a built-in gain asset, uses it in its business, the wearing out or obsolescence of the asset must be matched with the earnings generated by its use. In practice, to restrict basis adjustments to those derived from the subsidiary's earnings that are not related to the effective disposition of built-in gain assets, it would be necessary to appraise the subsidiary's assets, mark their bases to market (for earnings and profits purposes), and depreciate those bases over the assets' remaining economic life (also for earnings and profits purposes). Recurring appraisals may be required to deal with creeping acquisitions and fluctuations in the value of assets.

The possibility of adopting a tracing rule, but limiting the tracing of assets to a particular period was rejected because it would fail to prevent the elimination of corporate-level tax on income earned from the sale or operation of corporate assets.

Because of the administrative burdens that tracing would place on both taxpayers and the Service and because tracing relies heavily on accurate appraisals, tracing was rejected as a solution to the problems presented by the repeal of the *General Utilities* doctrine.

2. Built-in Gain Presumptions

A simpler, but less accurate, method of preventing the investment adjustment rules from eliminating

corporate-level tax would be to create a presumption concerning the extent to which a subsidiary's recognized gain is built-in gain and to eliminate positive adjustments to the basis of the subsidiary's stock to that extent. The presumption would be irrebuttable because the ability to rebut the presumption would entail tracing and its administrative burdens.

For example, such a presumption might apply to disallow positive adjustments for 50 percent of the subsidiary's post-acquisition income, up to the amount of its built-in gain. If this were the rule, a subsidiary that had $50 or more of built-in gain and $100 of post-acquisition income would be permitted positive adjustments, for earnings and profits purposes, of only $50. The presumption would not necessarily have to relate to all post-acquisition income. It could instead apply to a percentage of all gains recognized on dispositions of assets by the subsidiary or be restricted to extraordinary dispositions of assets.

Adoption of any presumption produces the correct result only if the actual facts correlate with the facts presumed—for example, if 50 percent of a subsidiary's $100 of post-acquisition income is in fact from the disposition or consumption of built-in gain assets. If the facts do not correlate—for example, if all $100 of a subsidiary's post-acquisition income represents operating income not attributable to built-in gain or, on the other hand, operating income entirely attributable to built-in gain—the basis of the subsidiary's stock would increase by $50 in both cases, but its value would increase by either $100 (where all of the income was not attributable to built-in gain) or $0 (where all of the income was attributable to built-in gain). Thereafter, if the stock of the subsidiary is sold for its fair market value, there will either be a $50 gain, in which case $50 of the subsidiary's income will have been taxed twice, or a $50 loss, in which case $50 of the subsidiary's income will not have been taxed at all. Thus, a presumption rule would impose harsh results in some cases while failing to prevent the elimination of corporate-level tax in other cases.

Other presumption rules were also considered, but rejected. For example, a presumption based on the amount of net built-in gain at the time a subsidiary is acquired would permit the elimination of corporate-level tax where the built-in gain actually recognized exceeds the built-in loss actually recognized by more than the amount of the net built-in gain. On the other hand, a presumption based on gross built-in gain would prevent the elimination of corporate-level tax in all cases, but would amount to an unduly harsh restriction of positive basis adjustments in many cases.

3. Tracing/presumption combinations

Several approaches involving the combination of tracing with some form of presumption rule were determined to be unsatisfactory because of the degree of inaccuracy involved in any presumption rule and because of concern that the availability of tracing as an alternative would effectively require taxpayers to compare results, thereby compounding the complexity and administrative burdens occasioned by a pure tracing rule.

4. Loss Disallowance Combined with Tracing (Loss Limitation)

Consideration was also given to adopting a loss disallowance rule (discussed below), but permitting taxpayers to avoid disallowance of their losses by establishing that the loss was not attributable to investment adjustments resulting from the recognition of built-in gain in the subsidiary's assets. This approach, referred to as the loss limitation approach, was rejected because it was concluded that taxpayers, in order to take advantage of the rule, would be forced to resort to tracing, with all of its attendant complexity and administrative burdens for both taxpayers and the Service.

5. Summary

Each of the approaches discussed above presents either significant administrative burdens for taxpayers and the Service or permits an unacceptable level of elimination of corporate-level tax. In addition, none of these approaches addresses the problem of loss duplication.

E. The Loss Disallowance Rule

The regulations retain the present investment adjustment rules, but disallow any loss on the sale or other disposition by a member of the stock of a subsidiary. This loss disallowance rule eliminates the possibility that gain recognized on the disposition or consumption of an acquired subsidiary's built-in gain assets can be offset by a loss at the parent level created by an investment adjustment caused by the subsidiary's recognition of built-in gain, as in Examples 2 and 3. The rule therefore assures the imposition of a corporate-level tax on the subsidiary's recognized built-in gains.

The loss disallowance rule also prevents losses of the subsidiary (either unrealized losses or realized losses that have not been utilized by the group) from being duplicated as investment losses of the parent when the parent disposes of the subsidiary's stock. Although it can be argued that it is inappropriate to address the problem of loss duplication only as it relates to consolidated returns because the problem also occurs in the context of separate returns, this argument ignores the fact that the consolidated return regulations adopt a comprehensive approach to gain and loss duplication that represents a fundamental departure from separate return treatment. For example, the double taxation of a subsidiary's earnings in separate return situations has never been advanced as a rationale for not resolving the problem in the context of consolidated returns.

1. Effect of Loss Disallowance Rule on Post-Acquisition Gain

Although the loss disallowance rule disallows all loss on the sale of a subsidiary's stock by a member, it has no impact in situations in which basis increases resulting from the recognition of built-in gain do not create (or contribute to) an overall loss on the sale. This aspect of the rule will in many cases permit the parent to shelter post-acquisition appreciation in stock of an acquired subsidiary.

Example 5. Corporation S has two assets, one with a basis of $0 and a value of $100 and the other with a basis and value of $0. P buys all the stock of S for $100 and P and S elect to file consolidated returns. S sells the first asset for $100. The second asset appreciates in value to $100. P then sells the S stock for $200. Because P's basis in its S stock was increased from $100 to $200 as a result of the sale of

the first asset, P has no gain or loss on the sale of S's stock.

In Examples 2 and 3, the basis increase resulting from S's recognition of built-in gain created a loss on P's sale of the S stock that would, but for the operation of the loss disallowance rule, offset the gain recognized by S. In Example 5, because of the post-acquisition increase in value of the second asset, the basis increase does not create a loss, but instead shelters P's investment gain on the sale of the S stock.

There is, however, a crucial distinction between Examples 2 and 3, and Example 5. In Examples 2 and 3, permitting the basis increase resulting from S's recognition of built-in gain to create a loss on P's sale of the S stock would mean that a corporate-level tax would *never* be collected with respect to the gain realized by S (because the purchaser would take a stepped-up basis in the S assets). In Example 5, however, the investment gain that is not taxed to P on the sale of S's stock is a duplication of gain that remains preserved in the low basis of S's second asset. Thus, the loss disallowance rule would permit the elimination of gain on the sale of the S stock that would be duplicated when S sells its assets.

To prevent taxpayers from aligning post-acquisition gain with loss otherwise subject to disallowance, the regulations provide an "anti-stuffing" rule that prevents avoidance of potential loss on the sale of a subsidiary's stock through the transfer of built-in gain assets to increase the value of the stock. The rule applies only to assets transferred to a subsidiary by any member of the group within the two years preceding the group's disposition of the subsidiary's stock.

2. Effect of Loss Disallowance Rule on Post-Acquisition Loss

As previously discussed, the investment adjustment rules were designed to prevent "inside" gain or loss on the disposition of a subsidiary's assets from being duplicated as "outside" gain or loss when the group disposes of the subsidiary's stock. However, the present rules do not eliminate this duplication when the group recognizes its outside gain or loss (by selling the subsidiary's stock) before the subsidiary recognizes its inside gain or loss (by selling its assets).

The loss disallowance rule eliminates loss duplication. It also eliminates gain duplication in situations such as Example 5, in which basis adjustments resulting from the recognition of built-in gain by the subsidiary provide shelter for the parent if it sells the subsidiary's stock before the subsidiary recognizes post-acquisition appreciation in its assets. This results in an exception to the general rule that gain or loss is recognized when a taxpayer liquidates its investment (such as when P sells the S stock in Examples 4 and 5). This exception is necessary to avoid the complexities and administrative burdens of tracing. In these cases, the recognition of post-acquisition gain or loss is deferred until the subsidiary disposes of the assets.

Because taxpayers are generally free to arrange their affairs to minimize the tax cost, they have an incentive to structure their transactions to preserve the deferral of post-acquisition gain permitted by the loss disallowance rule. This does not mean, however, that the benefit of post-acquisition loss must also always be deferred. The selling group may be able to elect deemed asset sale treatment under section 338(h)(10) on the sale of a subsidiary. Under section 338(h)(10), the group's stock sale is ignored and its gain or loss is determined by reference to the gain or loss inherent in the subsidiary's assets. Thus, although the loss disallowance rule does not permit a stock loss to duplicate the unrealized loss in a subsidiary's assets, the selling group may nevertheless realize the tax benefit of this unrealized loss through a section 338(h)(10) election.

The selling group may also avoid the effect of the loss disallowance rule by causing the subsidiary to sell assets reflecting post-acquisition loss or built-in loss and using the losses on the group's consolidated return. If losses have been recognized but not used, the temporary regulations provide a special rule which permits the common parent of the group to retain such losses of the subsidiary (or of any lower-tier subsidiary) to the extent loss is disallowed on the sale of the subsidiary's stock. Thus, recognized losses may be retained by the selling group or apportioned to the subsidiary that is sold, at the election of the common parent. This provides the group additional flexibility to avoid the effects of the loss disallowance rule, for example, in situations where selective sales of the subsidiary's loss assets or the election of deemed asset sale treatment under section 338(h)(10) is not desirable or feasible.

3. Loss of Built-in Gain

In arriving at the decision to adopt a loss disallowance rule, the Treasury Department and the Service considered cases in which a group has an economic loss on its investment in a subsidiary because built-in gain in the subsidiary's assets has been "lost" as a result of a decline in the value of the assets.

Example 6. Corporation S has one asset with a basis of $0 and a value of $100. Corporation P buys all the stock of S for $100 and P and S elect to file consolidated returns. S's asset declines in value and is sold for $0. Because S's sale of its asset results in no gain or loss, P's basis in S remains $100. P then sells S for $0 and recognizes a loss of $100. The loss is disallowed by the loss disallowance rule.

It may be argued that P's loss should not be disallowed in this case, because there is no possibility for S to duplicate the loss, as in Example 4, and there are no self-help techniques available to P. To provide this exception in a case where S has multiple assets, however, it would be necessary to require P to show that its loss on the sale of S is attributable to a decline in the amount of S's built-in gain and not a decline in value that could allow S to claim a loss. Thus, the exception would require tracing and would also entail ordering rules that would produce arbitrary results.

In any case, the decline in the value of built-in gain assets provides the potential for eliminating corporate-level tax, as illustrated by the following example.

Example 7. The facts are the same as in Example 6, except that, although the asset declines in value to $0, S earns $100 not attributable to built-in gain. The $100 of earnings causes P's basis in S to increase to $200. P then sells S for $100 and recognizes a $100 loss, which is disallowed by the loss disallowance rule.

In Example 7, P's $100 loss, if not disallowed, would offset S's $100 of income on the P group's consolidated return. From P's point of view, the result in Example 7 is the same as the results in Examples 2 and 3. In each case, P buys S for $100, receives a $100 basis increase because of S's $100 of income and recognizes a $100 loss on the sale of the S stock. In each case, S's $100 of income will permanently escape corporate-level taxation unless P's loss is disallowed.

Thus, Example 7 closely resembles Examples 2 and 3. In fact, many cases that appear to be Example 7 cases are in reality Example 3 cases. These are cases in which built-in gain that appears to have been "lost," as in Example 6, has been converted into income, as in Example 3. In view of the above, it was decided not to adopt an exception to the loss disallowance rule for cases involving the loss of built-in gain.

F. Transition Rule

Notice 87-14 stated that the regulations dealing with the effect of built-in gains on investment adjustments "will be effective with respect to stock in a target that was acquired after January 6, 1987." Notice 87-14 anticipated the issuance of regulations under the authority of section 337(d), which gives the Treasury Department broad authority to prevent circumvention of *General Utilities* repeal. The Treasury Department and the Service believe that transitional relief is warranted because Notice 87-14 did not describe the loss disallowance rule that is adopted in these regulations.

Accordingly, §1.337(d)-1T provides a loss limitation rule that applies with respect to stock of corporations that became members of a group after January 6, 1987, ("transitional subsidiaries") if the stock is disposed of and temporary regulations §1.1502-20T does not apply with respect to the disposition. This rule disallows loss on the disposition of stock of a transitional subsidiary except to the extent the taxpayer establishes that the loss is not attributable to basis increases resulting from the recognition of built-in gain by the subsidiary.

G. Explanation of Provisions—Prospective Rules

1. Loss Disallowance Rule

No deduction is allowed for any loss recognized by a member with respect to the disposition of stock of a subsidiary. The rule does not affect the use by the group of "inside" losses of the subsidiary, such as operating losses. There is an exception to the rule to the extent the member recognizes gain in the same transaction with respect to stock of the same subsidiary.

2. Basis Reduction on Deconsolidation

The basis of a subsidiary's stock is reduced to its fair market value immediately before the subsidiary's stock is deconsolidated. Stock is treated as deconsolidated when it is no longer owned by a member of any consolidated group of which the subsidiary is also a member.

The basis reduction rule complements the loss disallowance rule by eliminating loss that is built into the basis of the subsidiary's stock immediately before the stock ceases to be subject to the loss disallowance rule. For example, assume that a group sells 25 percent of a subsidiary's stock to a nonmember, thus disaffiliating the subsidiary. The group has a built-in loss in the subsidiary's stock that it continues to own, but because the stock is no longer subject to the loss disallowance rule, the basis of the stock is reduced to its fair market value to eliminate the loss.

A special rule applies in cases in which the basis of stock of a subsidiary is reduced, and the group realizes a loss on the disposition of the stock within 2 years after the basis reduction. The taxpayer must attach a statement to the return for the year of the disposition, disclosing the amount realized and the amount of loss on the disposition. If the statement is not attached to the return, no deduction is allowed for any loss claimed on the disposition.

3. Anti-Stuffing Rule

As described above in the general discussion of the loss disallowance rule, basis increases in the stock of a subsidiary resulting from the disposition or consumption of built-in gain assets can have the effect of deferring tax on unrealized post-acquisition gain of the subsidiary's assets when the subsidiary's stock is sold. The regulations contain an anti-stuffing rule to prevent a group from creating a comparable benefit by transferring appreciated property to a subsidiary and thereby avoiding the impact of the loss disallowance rule on the sale of the subsidiary's stock.

4. Earnings and Profits and Investment Adjustments

The regulations clarify that the earnings and profits of a member are reduced by the amount of a loss on the sale of a subsidiary's stock, even though the loss is disallowed.

The regulations also provide that a member's earnings and profits are reduced by the amount of the basis reduction required on the deconsolidation of stock of a subsidiary. This rule is needed because the basis reduction eliminates a future recognition of the loss (and the associated future reduction in earnings and profits).

Under the investment adjustment rules, these reductions in earnings and profits tier up and cause disallowed losses and basis reductions on deconsolidation to be reflected as reductions in the basis of higher tier members. Special rules are provided to prevent investment adjustments in situations where they would overlap with basis reductions under §1.1502-20T.

The regulations also make clear that, for purposes of the consolidated return regulations, a basis reduction under §1.1502-20T is treated as an investment adjustment under §1.1502-32(e). Thus, any consolidated return rule that applies to investment adjustments also is applicable to basis reductions under §1.1502-20T. For example, a member's basis reduction account under §1.1502-32T is determined by taking into account the net negative adjustments under §1.1502-32(e)(1) for all consolidated return years. Accordingly, any basis reduction in the member's stock under §1.1502-20T would be treated as a §1.1502-32(e)(1) adjustment for purposes of determining the amount of the basis reduction account.

5. Election to Retain Losses of Subsidiary

A common parent may elect to reattribute to itself the portion of a consolidated loss carryover attribut-

able to a subsidiary (or to a lower-tier subsidiary) that is leaving the group. If the election is made, the carryover is not apportioned to the subsidiary under §1.1502-79. Instead it remains part of the consolidated net operating loss or net capital loss of the group. This special rule applies only to the extent that a member is otherwise subject to loss disallowance with respect to the subsidiary's stock and the losses are not from separate return limitation years.

The common parent may elect to identify particular losses of a subsidiary (or lower tier subsidiary) to retain, notwithstanding their character or the year in which they arose. Retained losses may not be carried back to any prior taxable year of the common parent.

Solely for the purpose of the investment adjustment rules, a loss that is reattributed to the common parent is treated as absorbed by the subsidiary (or lower tier subsidiary), thereby causing a reduction in the stock basis and earnings and profits of the subsidiary whose losses are reattributed. These adjustments reduce the members' stock basis and earnings and profits to reflect the loss. The adjustments reduce or eliminate the member's loss on the disposition of the subsidiary's stock, thus reducing or eliminating the impact of the loss disallowance rule on the disposition.

6. Effective Dates

The loss disallowance rule and the basis reduction on deconsolidation apply with respect to stock disposed of or deconsolidated on or after March 9, 1990. The anti-stuffing rule applies only with respect to transfers of assets on or after that date.

H. Explanation of Provisions--Transition Rules

1. Loss Limitation Rule

Temporary regulations §1.337(d)-1T disallows a deduction for any loss recognized by a member with respect to the disposition of stock of a transitional subsidiary (or any subsidiaries that are higher-tier subsidiaries with respect to the transitional subsidiary), except to the extent the taxpayer establishes that the loss is not attributable to the recognition of built-in gain. A transitional subsidiary is any corporation that became a subsidiary in the group after January 6, 1987.

2. Effective Date

Section 1.337(d)-1T does not contain provisions comparable to the basis reduction rules of temporary regulations §1.1502-20T. The loss limitation rule therefore applies with respect to dispositions occurring after January 6, 1987, of stock of a transitional corporation (or any equity interest the basis of which is determined, directly or indirectly, in whole or in part, by reference to the basis of stock of a transitional corporation), but only if the disposition is not subject to §1.1502-20T.

I. Additional Relief

Losses disallowed by the temporary regulations may in some instances include economic losses in circumstances in which the taxpayer cannot utilize the self-help measures described above (or other self-help measures) to obtain deductions for the losses. The Treasury Department and the Service invite comments from taxpayers and professional groups as to appropriate circumstances for additional relief under the temporary regulations, possibly including, for example, rare and unusual circumstances in which relief would be appropriate and could be provided without heavy administrative burdens.

The Treasury Department and the Service also invite comments on whether the relief for cases in which the loss is related to gain taken into account in the same transaction should be extended to other situations.

J. Consideration of Anti-breakup Rule

The Treasury Department and the Service recognize that the ability to shelter post-acquisition gain that is inherent in the loss disallowance rule might be used to facilitate corporate breakups. This is because, in many cases, the assets of a breakup target that are intended to be sold reflect separate market values not fully reflected in the price paid for the target. Although the temporary regulations do not include an anti-breakup rule, serious consideration is being given to adopting some form of anti-breakup rule in the final regulations. The rule would prevent the sheltering of post-acquisition gain when a target is disposed of within 2 years after its stock is acquired by the group. To provide such a rule without the complexity of tracing may require eliminating the net positive adjustments with respect to the target stock (and the effect of distributions of earnings and profits that do not reduce basis). It is intended that the anti-breakup rule would apply on a retroactive basis from the effective date of §1.1502-20T.

Public comment is invited concerning the need for an anti-breakup rule, the form such a rule might take and whether or not such a rule should be retroactive.

Special Analysis

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It is hereby certified that these rules do not have a significant impact on a substantial number of small entities. The rules will primarily affect affiliated groups of corporations filing (or required to file) consolidated returns, which tend to be larger businesses. It will not significantly alter the reporting or recordkeeping duties of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. Chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR Chapter I, Part 1 is amended as follows:

PART 1-INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1986

Paragraph 1. The authority citation for Part 1 is amended by adding the following citations:

Authority: 26 U.S.C. 7805; *** §1.337(d)-1T also issued under 26 U.S.C. 337(d) *** §1.1502-20T also issued under 26 U.S.C. 337(d) and 1502.

Par. 2. New section 1.337(d)-1T is added to read as follows:

§1.337(d)-1T Transitional loss limitation rule (temporary).

(a) *Loss limitation rule for transitional subsidiaries*—(1) *General rule.* No deduction is allowed for any loss recognized by a member of a consolidated group with respect to the disposition of stock of a transitional subsidiary.

(2) *Exception*—(i) *In general.* Paragraph (a)(1) of this section does not apply to the extent the taxpayer establishes that the loss is not attributable to the recognition of built-in gain by any transitional subsidiary on the disposition of an asset after January 6, 1987, but only if a separate statement is filed with the taxpayer's return for the year of the stock disposition.

(ii) *Contents of statement and time of filing.* The statement required to be filed under paragraph (a)(2)(i) of this section must contain the name and employer identification number (E.I.N.) of the transitional subsidiary, the amount realized, and the amount of the deduction not disallowed under paragraph (a)(1) of this section. If the separate statement is required to be filed with a return the due date (including extensions) of which is before May 16, 1990, or with a return due after May 15, 1990 (including extensions), but filed before that date, the statement may be filed with the taxpayer's first subsequent return the due date (including extensions) of which is after May 15, 1990.

(3) *Definitions.* For purposes of this section—

(i) The definitions in §§1.1502-1, 1.1502-1T, and 1.1502-20T apply.

(ii) "Transitional subsidiary" means any corporation that became a subsidiary of the group (whether or not the group was a consolidated group) after January 6, 1987. Notwithstanding the preceding sentence, a subsidiary is not a transitional subsidiary if the subsidiary (and each predecessor) was a member of the group at all times after the subsidiary's (and each predecessor's) organization.

(iii) "Built-in gain" of a transitional subsidiary means any excess of value over basis, determined immediately before the transitional subsidiary became a subsidiary, with respect to any asset (including stock)—

(A) Owned directly or indirectly by the transitional subsidiary at that time, or

(B) The basis of which is determined, directly or indirectly, in whole or in part, by reference to the basis of an asset described in paragraph (a)(3)(iii)(A).

(4) *Examples.* For purposes of the examples in this section, unless otherwise stated, the group files consolidated returns on a calendar year basis, and the facts set forth the only corporate activity. Unless otherwise stated, all sales and purchases are with unrelated buyers or sellers. The basis of each asset is the same for determining earnings and profits adjustments and taxable income. Tax liability and its effect on basis, value, and earnings and profits are disregarded. "Investment adjustment system" means the rules of §§1.1502-32 and 1.1502-33(c). The principles of this paragraph (a) are illustrated by the following examples:

Example (1). Loss attributable to recognized built-in gain. P buys all the stock of T for $100 on February 1, 1987, and T becomes a member of the P group. T has an asset with $100 of built-in gain. T sells the asset in 1989 and recognizes the $100 of gain on the sale. Under the investment adjustment system, P's basis in T increases to $200. P sells all the stock of T on December 31, 1989, and recognizes a loss of $100. Under paragraph (a)(1) of this section, no deduction is allowed to P for the $100 loss.

Example (2). Loss attributable to economic loss. P buys all the stock of T for $100 on February 1, 1987, and T becomes a member of the P group. T has $50 cash and an asset with $50 built-in gain. During 1988, T retains the asset but loses $40 of the cash. The P group is unable to use the loss, and the loss becomes a consolidated net operating loss carryover attributable to T. Under the investment adjustment system, P's basis in the stock of T remains $100. P sells all the stock of T on December 31, 1988 for $60 and recognizes a $40 loss. Under paragraph (a)(2)(i) of this section, P establishes that it did not dispose of the built-in gain asset. None of P's loss is disallowed under paragraph (a)(1) if P satisfies the requirements of paragraph (a)(2)(ii) of this section.

Example (3). Stacking rules—stock loss attributable to either economic loss or recognized built-in gain. P buys all the stock of T for $100 on February 1, 1987, and T becomes a member of the P group. T has two assets. Asset 1 has a basis and value of $50, and asset 2 has a basis of $0 and a value of $30. During 1989, asset 1 declines in value to $0, and T sells asset 2 for $50, and reinvests the proceeds in asset 3. Asset 3 appreciates to $90. Under the investment adjustment system, P's basis in the stock of T increases from $100 to $150 as a result of the gain recognized on the sale of asset 2 but is unaffected by the unrealized post-acquisition decline in the value of asset 1. On December 31, 1989, P sells all the stock of T for $90 and recognizes a $60 loss. Although T incurred a $50 economic loss because of the decline in the value of asset 1, T also recognized $50 of built-in gain. Under paragraph (a)(2) of this section, any loss on the sale of stock is treated first as attributable to recognized built-in gain. Thus $50 of the $60 loss is attributable to the recognition of built-in gain on the disposition of assets. Therefore, only $10 of P's $60 loss is allowed if P satisfies the requirements of paragraph (a)(2) of this section.

Example (4). Outside basis partially corresponds to inside basis. (i) Individual A owns all the stock of T, for which A has a basis of $60. On February 1, 1987, T owns one asset with a basis of $0 and a value of $100, P acquires all the stock of T from A in an exchange to which section 351(a) applies, and T becomes a member of the P group. P has a carryover basis of $60 in the T stock. During 1988, T sells the asset and recognizes $100 of gain. Under the investment adjustment system, P's basis in T increases from $60 to $160. T reinvests the $100 proceeds in another asset, which declines in value to $90. On January 1, 1989, P sells all the stock of T for $90 and recognizes a loss of $70.

(ii) Although P's basis in the T stock was increased by $100 as a result of the recognition of built-in gain on the disposition of T's asset, only $60 of the $70 loss on the sale of the stock is attributable under paragraph (a)(2) of this section to the recognition of built-in gain from the disposition of the asset. (Had T's asset not declined in value to $90, the T stock would have been sold for $100, and a $60 loss would have been attributable to the recognition of the built-in gain.) Therefore, $10 of the $70 loss is allowed if P satisfies the requirements of paragraph (a)(2). If P had sold the stock of T for $95 because T's other assets had unrealized appreciation of $5, $60 of the $65 loss would still be attributable to T's recognition of built-in gain on the disposition of assets.

Example (5). Creeping acquisition. P owns 60 percent of the stock of S on January 6, 1987. On February 1, 1987, P buys an additional 20 percent of the stock of S, and S becomes a member of the P group. P sells all the S stock on March 1, 1989 and recognizes a loss of $100. All 80 percent of the stock of S owned by P is subject to the rules of this section and, under paragraph (a)(1) and (2) of this section, no deduction is allowed to P for the $100 loss, except to the extent P establishes the loss is not attributable to the recognition by S of built-in gain on the disposition of assets.

(b) *Indirect disposition of transitional subsidiary—(1) Loss limitation rule for transitional parent.* No deduction is allowed for any loss recognized by a member of a consolidated

group with respect to the disposition of stock of a transitional parent.

(2) *Exception.* Paragraph (b)(1) of this section does not apply to the extent the taxpayer establishes that the loss exceeds the amount that would be disallowed under paragraph (a) of this section if each highest tier transitional subsidiary's stock in which the transitional parent has a direct or indirect interest had been sold immediately before the disposition of the transitional parent's stock. In applying the preceding sentence, appropriate adjustments shall be made to take into account circumstances where less than all the stock of a transitional parent owned by members of a consolidated group is disposed of in the same transaction, or the stock of a transitional subsidiary or a transitional parent is directly owned by more than one member.

(3) *Definitions.* For purposes of this section—

(i) "Transitional parent" means any subsidiary, other than a transitional subsidiary, that owns a direct or indirect interest in the stock of a transitional subsidiary, and

(ii) "Highest tier transitional subsidiary" means the transitional subsidiary (or subsidiaries) in which the transitional parent has a direct or indirect interest and that the highest transitional subsidiary (or subsidiaries) in a chain of members.

(4) *Examples.* The principles of this paragraph (b) are illustrated by the following examples:

Example (1). Ownership of chain of transitional subsidiaries. (i) P forms S with $200 on January 1, 1985, and S becomes a member of the P group. On February 1, 1987, S buys all the stock of T, and T buys all the stock of T1, and both T and T1 become members of the P group. On January 1, 1988, P sells all the stock of S and recognizes a $90 loss on the sale.

(ii) Under paragraph (a)(3)(ii) of this section, both T and T1 are transitional subsidiaries, because they became members of the P group after January 6, 1987. Under paragraph (b)(3)(i) of this section, S is a transitional parent, because it owns a direct interest in stock of transitional subsidiaries and is not itself a transitional subsidiary.

(iii) Under paragraph (b)(2) of this section, because S is a transitional parent, no deduction is allowed to P for its $90 loss except to the extent it exceeds the amount of S's loss that would have been disallowed if S had sold all the stock of T, S's highest tier transitional subsidiary, immediately before P's sale of all the S stock. Assume all the T stock would have been sold for a $90 loss and that all the loss would be attributable to the recognition of built-in gain from the disposition of assets. Because in that case $90 of loss would be disallowed, all of P's loss on the sale of the S stock is disallowed under paragraph (b)(1).

Example (2). Ownership of brother-sister transitional subsidiaries. (i) P forms S with $200 on January 1, 1985, and S becomes a member of the P group. On February 1, 1987, S buys all the stock of both T and T1, and T and T1 become members of the P group. On January 1, 1988, P sells all the stock of S and recognizes a $90 loss on the sale.

(ii) Under paragraph (b)(2) of this section, no deduction is allowed to P for its $90 loss except to the extent P establishes that the loss exceeds the amount of S's stock losses that would be disallowed if S sold all the stock of T and T1, S's highest tier transitional subsidiaries, immediately before P's sale of all the S stock. Assume that all the T stock would have been sold for a $50 loss, all the T1 stock for a $40 loss, and that the entire amount of each loss would be attributable to the recognition of built-in gain on the disposition of assets. Because $90 of loss would be disallowed with respect to the sale of S's T and T1 stock, P's loss on the sale of all the S stock is disallowed under paragraph (b)(1).

(c) *Successors*—(1) *General rule.* If this section applies to disallow the deduction of a member for a loss on the disposition of stock of a subsidiary, it also applies in a similar manner, to the extent necessary to carry out the purposes of this section, to any successor to the member and to stock or other equity interests of any successor to the subsidiary. A successor is any entity the basis of whose equity interests is determined, directly or indirectly, in whole or in part, by reference to the basis of the subsidiary's stock.

(2) *Examples.* The application of this paragraph (c) is illustrated by the following examples:

Example (1). Merger into grandfathered subsidiary. P, the common parent of a group, owns all the stock of T, a transitional subsidiary. On January 1, 1989, T merges into S, a subsidiary that is not a transitional subsidiary. Under paragraph (c)(1) of this section, all the stock of S is treated as stock of a transitional subsidiary. As a result, no deduction is allowed for any loss recognized on the disposition of any S stock owned by a member, except to the extent the P group establishes under paragraph (a)(2) that the loss is not attributable to the recognition of built-in gain on the disposition of assets of T.

Example (2). Nonrecognition exchange of transitional stock. P, the common parent of a group, owns all the stock of T, a transitional subsidiary. On January 1, 1989, P transfers the stock of T to X, a corporation that is not a member of the P group, in exchange for 20 percent of its stock in a transaction to which section 351(a) applies. Under paragraph (c)(1) of this section, all the stock of X owned by members of the P group is treated as stock of a transitional subsidiary. As a result, no deduction will be allowed for any loss recognized on the disposition of any X stock owned by a member, except to the extent permitted under paragraph (a) of this section. Moreover, under paragraph (c)(1), X is treated as a member owning the stock of T, and T continues to be a transitional subsidiary with respect to X.

(d) *Earnings and profits and investment adjustments*—(1) *In general.* For purposes of computing the earnings and profits of a corporation and any investment adjustments with respect to stock, appropriate adjustments consistent with the rules of §1.1502-20T(e) shall be made.

(2) *Example.*(i) In 1986, P forms S with a contribution of $100 and S becomes a member of the P group. On February 1, 1987, S buys all the stock of T for $100. T has an asset with a basis of $0 and a value of $100. In 1988, T sells the asset for $100. As a result, under the investment adjustment system, S's basis in the T stock increases to $200, P's basis in the S stock increases to $200, and P's earnings and profits and S's earnings and profits increase by $100. In 1989, S sells T for $100, recognizing a loss of $100. The entire loss is disallowed under paragraph (a)(1) of this section.

(ii) Under paragraph (d)(1) of this section, S's earnings and profits for 1989 are reduced by $100, the amount of the loss disallowed under paragraph (a)(1). As a result, P's basis in the S stock is reduced from $200 to $100 under the investment adjustment system. P's earnings and profits for 1989 are correspondingly reduced by $100.

(e) *Effective date*—(1) *General rule.* This section applies with respect to any disposition of stock or other equity interest occurring after January 6, 1987, but only with respect to a disposition occurring on or after March 9, 1990, if the disposition is not subject to §1.1502-20T.

(2) *Binding contract rule.* For purposes of this section, if a corporation became a subsidiary pursuant to a binding written contract entered into and in continuous effect until the corporation became a subsidiary, or a disposition was pursuant to a binding written contract entered into and in continuous effect until the disposition, the date the contract became binding shall be treated as the date the corporation became a subsidiary or as the date of disposition.

Par. 3. New §1.1502-1T is added to read as follows:

§1.1502-1T Definitions (temporary).

Consolidated group. The term "consolidated group" means a group filing (or required to file) consolidated returns for the tax year.

Par. 4. Section 1.1502-12 is amended by adding at the end a new paragraph (r) to read as follows:

§1.1502-12 Separate taxable income.

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(r) *Cross-reference to temporary regulations.* For rules relating to loss disallowance or basis reduction on the disposition or deconsolidation of stock of a subsidiary, see §§1.337(d)-1T and 1.1502-20T.

Par. 5. New section 1.1502-20T is added under the heading "Computation of Separate Taxable Income" to read as follows:

§1.1502-20T Disposition or deconsolidation of subsidiary stock (temporary).

(a) *General rules*—(1) *Loss disallowance rule.* No deduction is allowed for any loss recognized by a member with respect to the disposition of stock of a subsidiary.

(2) *Exception.* Paragraph (a)(1) of this section does not apply to the extent gain is recognized (but not deferred) in the same transaction by the member with respect to stock of the same subsidiary, or was recognized by any member with respect to stock of the same subsidiary in a prior transaction and is taken into account in the transaction.

(3) *Disposition.* "Disposition" means any event in which gain or loss is recognized, in whole or in part.

(4) *Examples.* For purposes of the examples in this section, unless otherwise stated, the group files consolidated returns on a calendar year basis, and the facts set forth the only corporate activity. Unless otherwise stated, all sales and purchases are with unrelated buyers or sellers. The basis of each asset is the same for determining earnings and profits adjustments and taxable income. Tax liability and its effect on basis, value, and earnings and profits are disregarded. "Investment adjustment system" means the rules of §§1.1502-32 and 1.1502-33(c). The principles of this paragraph (a) are illustrated by the following examples:

Example (1). Loss attributable to recognized built-in gain. P buys all the stock of T for $100, and T becomes a member of the P group. T has an asset with a basis of $0 and a value of $100. T sells the asset for $100. Under the investment adjustment system, P's basis in the T stock increases to $200. Five years later, P sells all the stock of T for $100 and recognizes a loss of $100. Under paragraph (a)(1) of this section, no deduction is allowed to P for the $100 loss.

Example (2). Effect of post-acquisition appreciation. P buys all the stock of T for $100, and T becomes a member of the P group. T has an asset with a basis of $0 and a value of $100. T sells the asset for $100. Under the investment adjustment system, P's basis in the T stock increases to $200. T reinvests the proceeds in an asset that appreciates in value to $180. Five years later, P sells all the stock of T for $180 and recognizes a $20 loss. Under paragraph (a)(1) of this section, no deduction is allowed to P for the $20 loss.

Example (3). Disallowance of duplicated loss. P forms S with a contribution of $100 in exchange for all the shares of S stock, and S becomes a member of the P group. S has an operating loss of $60. The group is unable to use the loss, and the loss becomes a consolidated net operating loss carryover attributable to S. Five years later, P sells the stock of S for $40, recognizing a $60 loss. Under paragraph (a)(1) of this section, P's $60 loss on the sale of the S stock is disallowed. (See paragraph (f) of this section for the elective reattribution of S's $60 net operating loss to P in connection with the sale.)

Example (4). Deemed asset sale election. (i) P forms S with a contribution of $100 in exchange for all the S stock, and S becomes a member of the P group. S buys an asset for $100, and the value of the asset declines to $40. P sells all the stock of S to P1 for $40. Under paragraph (a)(1) of this section, P's $60 loss on the sale of the S stock is disallowed.

(ii) If P and P1 instead elect deemed asset sale treatment under section 338(h)(10), T is treated as selling all of its assets, and no loss is recognized by P on its sale of the T stock. As a result of the recharacterization of the stock sale as an asset sale, the $60 loss in the asset is recognized. Under the section 338(h)(10) regulations, T is treated as liquidating into P following the deemed asset sale, and the $60 loss is inherited by P.

Example (5). Gain and loss recognized on sale of stock in one transaction. P, the common parent of a group, owns all 100 shares of the stock of T, with an aggregate basis of $50 in 50 shares and $100 in the other 50 shares. P sells all the stock of T in a secondary offering for $140. P therefore recognizes a gain of $20 on 50 shares and a loss of $30 on the other 50 shares. Under paragraph (a)(2) of this section, the amount of the $30 loss that would be disallowed under paragraph (a)(1) of this section is limited to $10 ($30 reduced by the $20 gain recognized on T stock in the same transaction).

Example (6). Deferred gain and recognized loss. P, the common parent of a group, owns all the stock of S and S owns all the stock of T, which has a basis of $100 and a value of $150. S distributes all the T stock to P and recognizes a $50 gain under section 311, which is deferred under §1.1502-14(c). P later sells all the T stock to a nonmember for $90 and recognizes a loss of $60. Under §1.1502-13(f), the $50 of deferred gain is taken into account on the sale of the T stock to the nonmember. Under paragraph (a)(2) of this section, the amount of the $60 loss disallowed under paragraph (a)(1) of this section is limited to $10 ($60 reduced by the $50 gain recognized on the T stock taken into account in the same transaction).

(b) *Basis reduction on deconsolidation*—(1) If a member's basis in a share of stock of a subsidiary exceeds its value immediately before a deconsolidation of the share, the basis of the share is reduced at that time to an amount equal to its value. If both a disposition and a deconsolidation occur with respect to a share in the same transaction, paragraph (a) applies and paragraph (b) does not apply to the share in connection with the transaction.

(2) *Deconsolidation.* "Deconsolidation" means any event that causes a share of stock of a subsidiary to be no longer owned by a member of any consolidated group of which the subsidiary is also a member.

(3) *Value.* "Value" means fair market value.

(4) *Dispositions within 2 years after basis reduction*—(i) *In general.* If the basis of stock has been reduced under paragraph (b)(1) of this section and a disposition of the stock occurs within 2 years after the date of the basis reduction, a separate statement must be filed with the taxpayer's return for the year of disposition. If the taxpayer fails to file the statement as required, no deduction is allowed for any loss recognized on the disposition.

(ii) *Contents of statement.* The statement required to be filed under this paragraph (b)(4) must disclose with respect to the disposition of stock the amount realized, the amount of the loss on the disposition, and the name and employer identification number (E.I.N.) of the subsidiary whose stock is disposed of.

(5) *Examples.* The principles of this paragraph (b) are illustrated by the following examples:

Example (1). Simultaneous application of loss disallowance rule and basis reduction rule to stock of the same subsidiary. P forms S with $100 in exchange for all 100 shares of S stock, and S becomes a member of the P group. The value of S declines from $100 to $50, and P sells 60 shares of S stock for $30. The sale causes a deconsolidation of the remaining 40 shares held by P. Under paragraph (b)(1) of this section, P must reduce the basis of the 40 shares of S stock it continues to own from $40 to $20, the value of the shares immediately before the deconsolidation. Although P's disposition of the 60 shares also causes a deconsolidation of these shares, paragraph (b)(1) of this section provides that paragraph (a) of this section applies to the shares that are both sold and deconsolidated in the same transaction. Under paragraph (a)(1), P's $30 loss on the sale of the 60 shares is disallowed.

Example (2). Deconsolidation of subsidiary stock upon contribution to a partnership. P buys all the stock of T for $100, and T becomes a member of the P group. P later transfers all the stock of T to partnership M in exchange for a partnership interest in M, in a transaction to which section 721 applies. At the time of the exchange, P's basis in the T stock

is $100 and the T stock's value is $75. Under paragraph (b)(1) of this section, the transfer to M causes a deconsolidation of the T stock, and P must reduce its basis in the T stock to $75, the stock's value immediately before the transfer to M. As a result, P has a basis of $75 in its interest in M, and M has a basis of $75 in the stock of T.

Example (3). Simultaneous application of loss disallowance rule and basis reduction rule to stock of different subsidiaries. (i) P owns all the stock of S, which in turn owns all the stock of S1, and S and S1 are members of the P group. P's basis in S is $100 and S's basis in S1 is $100. S1 buys all the stock of T for $100, and T becomes a member of the P group. T has an asset with a basis of $0 and a value of $100. T sells the asset for $100. Under the investment adjustment system, S1's basis in T, S's basis in S1, and P's basis in S each increase from $100 to $200. S then sells all the stock of S1 for $100 and recognizes a loss of $100.

(ii) Under paragraph (a)(1) of this section, S's $100 loss on the sale of the stock of S1 is disallowed.

(iii) If S1 and T are not members of a consolidated group immediately after the sale of the stock of S1, the T stock is deconsolidated, and under paragraph (b)(1) of this section, S1 must reduce the basis of the T stock to $100, its value immediately before the sale.

(iv) If S1 and T are members of a consolidated group immediately after the sale of the stock of S1, the T stock is not deconsolidated, and no reduction is required under paragraph (b)(1).

(c) *Successors*—(1) *General rule.* If a rule of this section applies to the stock of a subsidiary, it also applies to stock or other equity interests in any successor to the subsidiary to the extent necessary to effectuate the purposes of the rule. A successor is any entity the basis of whose equity interests is determined, directly or indirectly, in whole or in part, by reference to the basis of the subsidiary's stock.

(2) *Example.* (i) P, the common parent of a group, buys all the stock of T for $100. T's only asset has a basis of $0 and a value of $100. T sells the asset for $100, and buys another asset for $100. Under the investment adjustment system, P's basis in the T stock increases to $200, and the earnings and profits of P increase by $100. P later transfers all the stock of T to partnership M in exchange for a partnership interest in M, in a transaction to which section 721 applies. Less than two years later, P sells its interest in M for $80.

(ii) Under paragraph (b)(1) of this section, because the stock of T is deconsolidated on the transfer to M, P reduces its basis in the T stock to $100, the amount P determines to be the value of the stock immediately before the transfer. As a result, P has a basis of $100 in its interest in M, and M has a basis of $100 in the T stock.

(iii) When P sells its interest in M for $80, it recognizes a $20 loss. Under paragraph (b)(4) of this section, P is required to file a statement with its return for the year of its disposition of its interest in M in order to deduct its loss. P does not file the required statement. The failure to file the statement described in paragraph (b)(4) results in the disallowance of P's loss on the disposition of its interest in M.

(d) *Anti-stuffing rule*—(1) *Application.* This paragraph (d) applies if—

(i) A transfer of any asset (including stock) between members is followed by a related direct or indirect disposition of stock of a subsidiary within 2 years after the transfer, and

(ii) The transfer is with a view to avoiding, directly or indirectly, in whole or in part, the disallowance of loss on the disposition (or basis reduction with respect to a deconsolidation prior to the disposition) of, or the recognition of the unrealized gain on, the transferred asset.

(2) *Basis reduction.* If this paragraph (d) applies, the basis of the subsidiary's stock disposed of is reduced, immediately before the disposition (or deconsolidation prior to disposition), to cause recognition of gain in an amount equal to the loss disallowance (or basis reduction) or gain recognition otherwise avoided by reason of the transfer.

(3) *Examples.* The principles of this paragraph (d) are illustrated by the following examples:

Example (1). Basic stuffing case. (i) In Year 1, P buys all the stock of T for $100, and T becomes a member of the P group. T has an asset with a basis of $0 and a value of $100. T sells the asset for $100. Under the investment adjustment system, P's basis in T increases from $100 to $200. In Year 5, P transfers to T an asset with a basis of $0 and a value of $100 in a transaction to which section 351 applies, with the view described in paragraph (d)(1) of this section. In Year 6, P sells all the stock of T for $200.

(ii) Under paragraph (d)(2) of this section, P must reduce the basis in its T stock immediately before the sale to cause recognition of gain in an amount equal to the loss disallowance otherwise avoided by reason of the transfer. The amount of this basis reduction is $100, causing a $100 gain to be recognized on the sale.

Example (2). Stacking rules. (i) In Year 1, P buys all the stock of T for $100, and T becomes a member of the P group. T has an asset with a basis of $0 and a value of $100. T sells the asset for $100. Under the investment adjustment system, P's basis in the T stock increases from $100 to $200. In Year 5, when the value of the T stock remains $100, P transfers to T an asset with a basis of $0 and a value of $100 in a transaction to which section 351 applies, with the view described in paragraph (d)(1) of this section. Thereafter, the value of the contributed asset declines to $10. In Year 6, P sells all the T stock for $110.

(ii) Because the transferred asset declined in value by $90, the transfer enabled P to avoid the disallowance of loss on the sale of T only to the extent of $10. Under paragraph (d)(2) of this section, P must reduce the basis in its T stock immediately before the sale to cause recognition of gain in an amount equal to the loss disallowance otherwise avoided by reason of the transfer. The amount of this basis reduction is $100, causing a $10 gain to be recognized on the sale.

(iii) Assume, instead, that the transferred asset did not decline in value and that T reinvests the $100 in proceeds from the asset sale in another asset that appreciates in value to $190. In Year 6, P sells T for $290. Because the new asset appreciated in value by $90, the transfer enabled P to avoid the disallowance of loss on the sale of T only to the extent of $10. Under paragraph (d)(2) of this section, P must reduce the basis in its T stock immediately before the sale to cause recognition of gain in an amount equal to the loss disallowance otherwise avoided by reason of the transfer. The amount of this basis reduction is $10, causing a $100 gain to be recognized on the sale.

Example (3). Contribution of built-in loss asset. (i) In Year 1, P forms S with a contribution of $100 in exchange for all of S's stock, and S becomes a member of the P group. S buys an asset for $100, and the asset appreciates in value to $200. P then buys all the stock of T for $100, and T becomes a member of the P group. T has an asset with a basis of $0 and a value of $100. T sells the asset for $100, and under the investment adjustment system P's basis in the T stock increases from $100 to $200. In Year 5, when the value of the T stock remains $100, P transfers the T stock to S in a transaction to which section 351 applies, with the view described in paragraph (d)(1) of this section. The transfer causes P's basis in S to increase from $100 to $300 and the value of S to increase from $200 to $300. In Year 6, P sells S for $300.

(ii) Under paragraph (d)(2) of this section, P must reduce the basis in its S stock immediately before the sale to cause recognition of gain in an amount equal to the gain recognition otherwise avoided by reason of the transfer. The amount of this basis reduction is $100, causing a $100 gain to be recognized on the sale.

Example (4). Absence of view. (i) In Year 1, P forms S with a contribution of $100, and S becomes a member of the P group. S buys two assets, asset 1 with a basis of $50, which appreciates to $100, and asset 2 with a basis of $50 which declines in value to $0. S sells asset 1 for $100. Under the investment adjustment system, P's basis in S increases from $100 to $150. In Year 5, S transfers asset 2 to P in a transaction to which §1.1502-14(a) applies, with a view to avoiding disallowance of loss on the subsequent disposition of the S stock. This transfer reduces P's basis in S from $150 to $100. In Year 6, P sells all the stock of S for $100.

(ii) Because the transfer from S to P achieves a result that could have been obtained by other methods that would not have been prevented by this section, the transfer is not with the view described in paragraph (d)(1) of this section. P is in substantially the same position holding asset 2 as it would be if S sold the asset and the resulting loss was available to the P group (either through S or by reattribution under paragraph (f) of this section).

(e) *Earnings and profits and investment adjustments*—(1) *Effect on earnings and profits*—(i) *General rule.* For purposes of computing the earnings and profits of a member that

owns stock in a subsidiary, any deduction that is disallowed, or any amount by which basis is reduced, under this section is treated as a loss allowed in the tax year in which the disallowance or basis reduction occurs.

(ii) *Example.* (A) In year 1, P forms S with a contribution of $100, and S becomes a member of the P group. S buys all the stock of T for $100. T has an asset with a basis of $0 and a value of $100. In Year 2, T sells the asset for $100. Under the investment adjustment system, S's basis in the T stock increases to $200, and P's basis in the S stock increases to $200. In Year 6, S sells all the stock of T for $100, and S's recognized loss of $100 is disallowed under paragraph (a)(1) of this section.

(B) Under paragraph (e)(1) of this section, the earnings and profits of S for Year 6 are reduced by $100, the amount of the loss disallowed under paragraph (a)(1). P's basis in the S stock is reduced from $200 to $100 under the investment adjustment system. Correspondingly, P's earnings and profits for Year 6 are reduced by $100, the amount of the loss disallowed under paragraph (a)(1) of this section.

(2) *Coordination with investment adjustment rules*—(i) *Order of adjustments.* Deconsolidation of a share is treated as a disposition of the share for purposes of determining when investment adjustments are made to the share under §§1.1502-32 and 1.1502-32T.

(ii) *No tiering up of certain adjustments.* If the basis of stock of a subsidiary owned by a member (the "owning member") is reduced under this section upon the deconsolidation of the stock, no corresponding adjustment is made under §1.1502-32 to the basis of the stock of the owning member (or any higher tier member) if a disposition or deconsolidation occurs in the same transaction with respect to all the stock of the owning member. In the case of a disposition or deconsolidation in the same transaction of less than all the stock of the owning member, appropriate adjustments shall be made under §1.1502-32 with respect to the stock of the owning member (or any higher tier member).

(iii) *Example.* (A) P, the common parent of a group, owns all the stock of S, S owns all the stock of S1, and S1 owns all the stock of S2. P's basis in S is $100, S's basis in S1 is $100, and S1's basis in S2 is $100. In Year 1, S2 buys T for $100. T has an asset with a basis of $0 and a value of $100. In Year 2, T sells the asset for $100. Under the investment adjustment system, the basis of each subsidiary's stock increases from $100 to $200. In Year 6, S sells all the stock of S1 for $100 to A, an individual, and recognizes a loss of $100. S1, S2, and T are not members of a consolidated group immediately after the sale because the new S1 group does not file a consolidated return for its first taxable year.

(B) Under paragraph (a)(1) of this section, no deduction is allowed to S for its loss on the sale of the S1 stock. Under paragraph (e)(1) of this section, S's earnings and profits for Year 6 are reduced by the $100 loss that is disallowed. Correspondingly, under the investment adjustment system, S's reduction in earnings and profits causes a reduction in P's basis in S, and a reduction in P's earnings and profits for Year 6.

(C) Under paragraph (b)(1) of this section, because the stock of T and S2 is deconsolidated, S2 must reduce the basis of the T stock from $200 to $100 (its value immediately before the deconsolidation), and S1 must reduce the basis of the S2 stock from $200 to $100 (its value immediately before the deconsolidation). Under paragraph (e)(1), S2's earnings and profits for Year 6 are reduced by the $100 reduction to the basis of the T stock, and S1's earnings and profits are reduced by the $100 reduction to the basis of the S2 stock. Under paragraph (e)(2)(ii) of this section, because the stock of S2 is deconsolidated in the same transaction, the basis reduction to the T stock does not cause any corresponding investment adjustment to the stock of S2, or to the stock of any higher tier subsidiary. Similarly, because the stock of S1 is disposed of in the same transaction, the reduction to the basis of the S2 stock does not cause an investment adjustment to the stock of S1, or the stock of any higher tier subsidiary.

(iv) *Basis reduction treated as investment adjustment.* For purposes of the consolidated return regulations, the amount of any basis reduction to stock under this section is treated as a net negative adjustment under §1.1502-32(e) (in addition to the adjustment otherwise required under §1.1502-32(e)) with respect to the stock.

(f) *Reattribution of subsidiary's losses to common parent*—(1) *Reattribution rule.* If a member disposes of stock of a subsidiary and the member's loss is subject to disallowance under paragraph (a)(1) of this section, the common parent may elect to reattribute to itself any portion of the reattributable losses of the subsidiary without regard to the order in which they were incurred, provided the amount reattributed does not exceed the amount subject to disallowance before taking into account this paragraph (f). The common parent succeeds to the reattributed losses of the subsidiary (or the subsidiary's lower tier subsidiaries) as if the losses were succeeded to on the day of the disposition in a transaction to which section 381 applies.

(2) *Investment adjustments.* The reattributed losses are treated, solely for purposes of determining investment adjustments under §1.1502-32 and earnings and profits under §1.1502-33(c), as absorbed by the subsidiary (or any of its lower tier subsidiaries) immediately before the disposition. The losses, however, are not treated as absorbed for other tax purposes, such as section 172.

(3) *Definitions*—(i) *Reattributable losses of the subsidiary.* "Reattributable losses of the subsidiary" are losses that are reflected as a positive adjustment under §1.1502-32(b)(1)(ii) immediately before the subsidiary (or its lower tier subsidiaries) ceases to be a member with respect to the group that is disposing of its stock.

(ii) *Lower tier subsidiary.* "Lower tier subsidiary" means a subsidiary owned, directly or indirectly, by the subsidiary whose stock is disposed of.

(4) *Examples.* The principles of this paragraph (f) are illustrated by the following examples:

Example (1). Basic reattribution case. (i) P, the common parent of a group, forms S with a contribution of $100. S has an operating loss of $60, which produces a deficit in earnings and profits that reduces P's basis in the S stock by $60 under the investment adjustment system. The group is unable to use the loss, and the loss becomes a consolidated net operating loss carryover attributable to S. Under the investment adjustment system, P's basis in the S stock is increased by $60, the amount of the unused loss, thus preserving P's $100 basis in the S stock. The remaining assets of S appreciate in value, and P sells S for $55. Under paragraph (a)(1) of this section, but for the application of this paragraph (f), P's $45 loss on the sale of S is disallowed.

(ii) S's $60 portion of the consolidated net operating loss is reflected in stock basis as a positive adjustment of $60 to the basis of the S stock immediately before S ceases to be a member of the P group. Accordingly, under paragraph (f)(3)(i) of this section, this loss is the reattributable loss of S with respect to the disposition.

(iii) P elects under paragraph (f)(1) of this section to reattribute to itself $45 of the S loss (the maximum amount permitted). As a result, $45 of the $60 reattributable losses of S is reattributed to P. This reattributed loss may be included in the consolidated net operating loss carryover to subsequent consolidated return years of the P group. The remaining $15 of S's reattributable losses is carried over to the first separate return year of S.

(iv) The $45 reattributed loss is treated, solely for purposes of the investment adjustment system, as absorbed by S immediately before the disposition. This reduces P's basis in the S stock to $55 immediately before the disposition. As a result, P does not recognize any gain or loss on the disposition. However, this deemed absorption for purposes of determining investment adjustments does not affect the use of the loss by the P group or reduce the $45 limitation on the amount of the S loss that P may elect to reattribute.

(v) Assume that $20 of S's losses arose in Year 1 and $40 in Year 2, and that P elects to reattribute all $40 from Year 2 and $5 from Year 1. These losses retain their character as ordinary losses arising in Years 1 and 2. The losses continue to be subject to any limitations originally applicable to S, but P succeeds to them and may absorb the losses independent of S. (For example, P's use of the Year 2 losses does not depend on S's use of the Year 1 losses that were not reattributed to P.)

Example (2). Lower tier subsidiary. (i) The facts are the same as in Example (1), except that $10 of S's assets are invested in T in exchange for all of T's stock. T has an operating loss of $5, which is not used by the P group and becomes a consolidated net operating loss carryover attributable to T. Because of other appreciation, P's sale price for the S stock remains $55.

(ii) Under paragraph (f)(3)(i) of this section, all of T's loss is a reattributable loss with respect to a lower tier subsidiary of S. Therefore, T's loss is included in the losses that P may choose to reattribute, subject to the $45 limitation.

Example (3). Separate return limitation year losses. (i) The facts are the same as in Example (1), except that S buys all the stock of T for $10. T has a $30 loss carryover from a separate return limitation year.

(ii) T's loss is not reflected as a positive adjustment to the basis of its stock owned by S under §1.1502-32(b)(1)(ii) immediately before it ceased to be a member of the P group. Therefore, T's loss is not a reattributable loss, and the results in Example (1) are unaffected.

(5) *Time and manner of making the election*—(i) *In general.* (A) The election described in paragraph (f)(1) of this section must be made in a separate statement in the following (or a substantially similar) form: "THIS IS AN ELECTION UNDER SECTION 1.1502-20T(f)(1) OF THE INCOME TAX REGULATIONS TO REATTRIBUTE LOSSES OF [insert names and employer identification numbers (E.I.N.) of the subsidiary that ceased to be a member of the group and each lower tier subsidiary whose losses are reattributed] TO [insert name and employer identification number of common parent]."

(B) The statement must include the following information—

(*1*) For each subsidiary and lower tier subsidiary whose losses are reattributed, the amount of each net operating loss and net capital loss, and the year in which each arose, that is reattributed to the common parent, and

(*2*) If stock of a subsidiary (or any of its lower tier subsidiaries) is acquired by another corporation, the acquiring corporation's name and employer identification number.

The statement must be signed by the common parent and by each subsidiary and lower tier subsidiary with respect to which loss is reattributed under this paragraph (f). The statement must be filed with the consolidated group's income tax return for the tax year of the disposition and a copy delivered on or before the time that return is filed to the acquiring corporation of each subsidiary or lower tier subsidiary whose losses are reattributed. If the acquiring corporation is a subsidiary in a consolidated group, the name and employer identification number of the common parent of the group must be included in the statement, and a copy of the statement must also be delivered to the common parent.

(ii) *Filing of subsidiary's copy of statement.* The subsidiary (and any lower tier subsidiaries) whose losses are reattributed (or the common parent of the consolidated group that includes the subsidiary and any lower tier subsidiaries) must attach its copy of the statement described in paragraph (f)(5)(i) of this section to its return for the first year ending after the due date, including extensions, of the return in which the election required by paragraph (f)(5)(i) is to be filed.

(6) *Election irrevocable.* An election under paragraph (f)(1) of this section is irrevocable.

(g) *Effective dates*—(1) *General rule.* Except as otherwise provided in this paragraph (g), this section applies with respect to dispositions and deconsolidations occurring on or after March 9, 1990. For this purpose, transactions deferred under §§1.1502-13, 1.1502-13T, 1.1502-14, and 1.1502-14T are deemed to occur at the time the deferred gain or loss is taken into account.

(2) *Anti-stuffing rule.* Paragraph (d) of this section applies only with respect to transfers occurring on or after March 9, 1990.

(3) *Binding contract rule.* For purposes of paragraphs (g)(1) and (2) of this section, if the disposition, deconsolidation, or transfer was pursuant to a binding written contract entered into and in continuous effect until the disposition, deconsolidation, or transfer, the date the contract became binding is treated as the date of the disposition, deconsolidation, or transfer.

(4) *Cross reference.* For additional rules relating to loss disallowance, see §1.337(d)-1T.

Par. 6. Section 1.1502-32 is amended by adding at the end of paragraph (a) a new sentence to read as follows:

§1.1502-32 Investment adjustments.

(a) *In general.* *** For rules relating to loss disallowance or basis reduction on the disposition or deconsolidation of stock of a subsidiary, see §§1.337(d)-1T and 1.1502-20T.

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Par. 7. Section 1.1502-33(c)(6) is amended by adding a new sentence at the end to read as follows:

§1.1502-33 Earnings and profits.

*****

(c) ***

(6) *** For rules relating to the effect on earnings and profits of loss disallowance or basis reduction on the disposition or deconsolidation of stock of a subsidiary, see §§1.337(d)-1T and 1.1502-20T.

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Par. 8. Section 1.1502-79 is amended by adding paragraph (a)(1)(iii) to read as follows:

§1.1502-79 Separate return years.

(a) ***

(1) ***

(iii) For rules permitting the reattribution of losses of a subsidiary to the common parent in the case of loss disallowance or basis reduction on the disposition or deconsolidation of stock of the subsidiary, see §1.1502-20T.

*****

Need for temporary regulations

Because of the need to conform the consolidated return regulations to the repeal of the *General Utilities* doctrine, it is impracticable and contrary to the public interest to issue these temporary regulations with notice and public procedure under section 553(b) of title 5 of the United States Code, or subject to the effective date limitation of section 553(d) of title 5.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved March 1, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 9, 1990, 2:19 p.m., and published in the issue of the Federal Register for March 14, 1990, 55 F.R. 9426)

Subpart D.—Definition and Special Rule

Section 346.—Definition and Special Rule

26 CFR 1.346-1: Partial liquidation.

A pre-TEFRA rule providing that a surrender of stock is unnecessary for a pro rata distribution in partial liquidation to qualify under section 346 of the Code is extended to post-TEFRA pro rata distributions in partial liquidation under section 302(b)(4) and (e). See Rev. Rul. 90-13, page 65.

Part III. Corporate Organizations and Reorganizations

Subpart D.—Special Rule; Definitions

Section 367.—Foreign Corporations

26 CFR 1.367(a)-1T: Transfers to foreign corporations subject to section 367(a): In general (temporary).

T.D. 8280

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 7 and 602

Certain Corporate Distributions to Foreign Corporations Under Section 367(e)

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulation.

SUMMARY: This document provides temporary Income Tax Regulations relating to the distribution of stock and securities under section 355 and section 367(e)(1) by a domestic corporation to a person who is not a United States person, and also relating to a liquidating distribution of property under section 332 and section 367(e)(2) by a domestic or foreign corporation to a foreign corporation. These regulations are necessary to implement section 367(e)(1) and (2) as added by the Tax Reform Act of 1986. These provisions affect the taxability of the corporation making the distribution as well as its shareholders receiving the distribution. This document also provides temporary regulations under section 367(a) and (b) relating to the closing of the taxable year and to the application of sections 354 and 361 in certain reorganizations under section 368(a)(1)(F). The text of the temporary regulations set forth in this document also serves as the text of the proposed regulations cross-referenced in *** [INTL-704-87, page 678, this Bulletin].

EFFECTIVE DATES: Except as set forth below, these regulations are effective with respect to distributions after July 31, 1986. The following provisions have the following special effective dates:

§1.367(a)-1T(e)	April 1, 1987
§1.367(a)-1T(f)	January 1, 1985
§1.367(e)-1T	February 1, 1985
§1.381(b)-1	April 1, 1987
§7.367(b)-1(e)	April 1, 1987
§7.367(b)-1(f)	January 1, 1985

SUPPLEMENTARY INFORMATION:

PAPERWORK REDUCTION ACT

This regulation is being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in this regulation has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under control number 1545-1124. The estimated average burden associated with the collection of information in this regulation is 8 hours per respondent or recordkeeper.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents/recordkeepers may require greater time, depending upon their particular circumstances.

For further information concerning this collection of information, and where to submit comments on this collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-reference notice of proposed rulemaking published *** [INTL-704-87, page 678, this Bulletin].

BACKGROUND

This document contains temporary regulations (26 CFR Parts 1, 7 and 602) under section 367(a), section 367(b) and section 367(e)(1) and (2) of the Internal Revenue Code of 1986, as revised by sections 631(d)(1) and 1810(g) of the Tax Reform Act of 1986 (100 Stat. 2085, 2272, Pub. L. 99-514) [1986-3 C.B. (Vol. 1) 1, 745]. Section 1006(e)(13) of the Technical and Miscellaneous Revenue Act of 1988 (102 Stat. 3342, Pub. L. 100-647) provided an amendment to the effective date for certain liquidations under section 367(e)(2) before June 10, 1987. The regulations are issued under the authority contained in section 367(a)(6), section 367(b)(1), section 367(e)(1) and (2) and section 7805(a).

NEED FOR TEMPORARY REGULATIONS

The regulations under section 367(a)(6) and (b)(1) that close the taxable year of the transferor corporation in certain inbound and outbound reorganizations under section 368(a)(1)(F) will apply to certain reorganizations occurring after March 30, 1987. This guidance, which effectuates prior announcements, is necessary so that taxpayers will know when to file the appropriate tax returns. The regulations under section 367(b)(1) that close the taxable year of the transferor corporation in certain foreign to foreign reorganizations under section 368(a)(1)(F) will generally apply to certain reorganizations occurring in a taxable year beginning after February 15, 1990. Taxpayers may choose to apply this rule to such reorganizations occurring in taxable years beginning after December 31, 1986.

The regulations under section 367(a)(6) and (b)(1) that clarify that there are exchanges under sections 354(a) and 361(a) in all inbound, outbound, and foreign to foreign reorganizations under section 368(a)(1)(F) will apply to reorganizations after December 31, 1984 (for temporary regulations under section 367(a)), and December 31, 1977 (for temporary regulations under section 367(b)). This guidance is being provided to apprise taxpayers of the transfers occurring in a reorganization and to prevent tax avoidance in these transactions.

The regulations under section 367(e)(1) will apply to distributions occurring after February 15, 1990. The regulations under section 367(e)(2) will generally apply to distributions after July 31, 1986. The temporary regulations under section

367(e)(1) and (2) will clarify the law in these areas and provide taxpayers with needed immediate guidance. Many taxpayers have not been able to effectuate distributions or liquidations. Furthermore, there is some uncertainty as to the tax consequences and reporting obligations with respect to such transactions. These effective dates are also necessary to prevent avoidance of tax and to provide regulatory relief in certain instances.

Accordingly, these regulations are not subject to the public notice requirements of 5 U.S.C. section 553(b) or to the effective date limitation of subsection (d) of that section.

EXPLANATION OF PROVISIONS

Closing of the Taxable Year and the Application of Sections 354 and 361 in Certain Reorganizations under Section 368(a)(1)(F)

Rev. Rul. 87-27, 1987-1 C.B. 134, and Rev. Rul. 88-25, 1988-1 C.B. 116, indicate that a reorganization can qualify under section 368(a)(1)(F) where the transferor corporation or the acquiring corporation is a foreign corporation. In such a reorganization, the taxable year of the transferor corporation did not close under section 381(b). Notice 87-29, 1987-1 C.B. 474, and Notice 88-50, 1988-1 C.B. 535, state that the regulations under section 367 would be revised to require the closing of the taxable year in a reorganization under section 368(a)(1)(F) of a domestic corporation into a foreign corporation (or vice versa). These regulations provide for the closing of the taxable year in certain instances.

Rev. Rul. 87-27 and Rev. Rul. 88-25 also reiterate that an exchange of stock for stock under section 354(a), and an exchange of assets for stock under section 361(a), occur in a reorganization under section 368(a)(1)(F) where the transferor or the acquiring corporation is a foreign corporation. This states existing law. Notice 87-29 and Notice 88-50 state that the regulations would be revised to clarify that there is an actual or constructive transfer of assets and an exchange of stock in all inbound, outbound, and foreign to foreign reorganizations under section 368(a)(1)(F). These regulations provide for such transfers and exchanges. Although the temporary regulations under section 367(a) relating to exchanges under sections 354 and 361 in certain reorganizations under section 368(a)(1)(F) are effective for reorganizations occurring after December 31, 1984, the Internal Revenue Service considers that the same rule would apply with respect to former regulations issued under the Tax Reform Act of 1976.

Distributions Described in Section 367(e)(1)

The distributing corporation in a distribution described in section 355(a) normally does not recognize gain or loss on the distribution of the stock of a controlled corporation to the distributing corporation's shareholders. However, gain may be recognized by a distributing domestic corporation in a section 355 distribution to a person who is not a United States person if and to the extent regulations issued under section 367(e)(1) so provide. In addition, gain may be required to be recognized pursuant to regulations to be issued under section 337(d).

Section 367(e)(1) specifically provides that, in the case of any distribution described in section 355 (or so much of section 356 as relates to section 355) by a domestic corporation to a person who is not a United States person, to the extent provided in regulations, gain shall be recognized under principles similar to the principles of section 367. Section 367(a) provides for the recognition of gain upon the transfer of property by a United States person to a foreign corporation in certain nonrecognition exchanges, unless an exception provided under section 367(a) or the regulations issued thereunder is applicable.

General Rule for Distributions Described in Section 367(e)(1)

The regulations provide, in general, that a distributing domestic corporation shall recognize gain upon the distribution of stock or securities of a domestic or foreign corporation to its shareholders who are not United States persons. An anti-abuse rule is included to prevent the distributing domestic corporation from selectively distributing high-basis blocks of controlled corporation stock to shareholders who are not United States persons in order to reduce the gain recognized on the distribution. The anti-abuse rule provides that, for purposes of determining the gain to be recognized by the distributing do mestic corporation on the distribution of stock or securities to shareholders who are not United States persons, the basis of the stock or securities distributed to shareholders who are not United States persons is considered to be the average basis of all of the particular class of stock or securities (as the case may be) owned by the distributing domestic corporation.

There are three exceptions to the general rule of gain recognition. The first exception applies to distributions where the distributing domestic corporation and the domestic controlled corporation are United States real property holding corporations immediately after the distribution. The second exception applies to certain distributions of stock of a domestic controlled corporation where five or fewer individuals or corporations directly own all of the outstanding stock (exclusive of directors' qualifying shares) of the distributing domestic corporation immediately before the distribution. The third exception applies to certain distributions of stock of a domestic controlled corporation by a domestic distributing corporation that is publicly traded where the foreign distributee owns five percent or less of the class of stock with respect to which the distribution is being made. A rule for determining the distributee's basis in the stock received is also included.

Distributions of the stock of a passive foreign investment company (as defined in section 1296(a)) will be subject to regulations to be issued under section 1291(f). Distributions of the stock of a passive foreign investment company before the effective date of those regulations are subject to the provisions of §1.367(e)-1T, and any gain recognized is subject to the provisions of section 1291 et seq.

Distributions Described in Section 367(e)(2)

The distributing corporation in a complete liquidation described in section 332(a) normally does not recog-

nize gain or loss under section 337(a) on the distribution of property to a corporation that meets the eighty percent stock ownership requirements of section 332(b). However, gain may be recognized pursuant to section 367(e)(2) by the distributing corporation in a section 332 distribution to which section 337 would otherwise apply if the parent corporation is a foreign corporation. Section 367(e)(2) specifically provides that, in the case of any liquidation to which section 332 applies, subsections (a) and (b)(1) of section 337 shall not apply where the eighty percent distributee is a foreign corporation. Thus, gain recognition is required by the distributing domestic or foreign corporation. However, section 367(e)(2) also provides that subsections (a) and (b)(1) of section 337 may apply to a distribution to a foreign corporation if and to the extent regulations so provide.

General Rule for Distributions by a Domestic Corporation Described in Section 367(e)(2)

The regulations provide, in general that a distributing domestic corporation in a section 332 liquidation shall recognize gain upon the distribution of property to a foreign parent corporation that owns at least eighty percent of the distributing domestic corporation. The regulations then specify the instances in which the distributing domestic corporation is not required to recognize gain on the distribution. These instances include the distribution of certain property which continues to be used in the conduct of a trade or business within the United States, the distribution of U.S. real property interests, and the distribution of property to certain foreign parent corporations covered by a transitional treaty rule. A rule for determining the distributee's basis in the property distributed is also included.

General Rule for Distribution by a Foreign Corporation Described in Section 367(e)(2)

The regulations provide, in general, that a distributing foreign corporation in a section 332 liquidation shall not recognize gain (or loss) upon the distribution of property to a foreign parent corporation that owns at least eighty percent of the stock of the distributing foreign corporation. However, recognition of gain is required on the distribution of property formerly or then used in the conduct of a trade or business within the United States by the distributing foreign corporation if the distributee foreign parent corporation will not continue to use the property in the conduct of a trade or business within the United States. A cross-reference is made to the regulations under section 897 for the treatment of the distribution or exchange of U.S. real property interests. Rules for determining the distributee's basis in the property are also provided.

Distributions of the stock of a passive foreign investment company (as defined in section 1296(a)) will be subject to regulations to be issued under section 1291(f). Distributions of the stock of a passive foreign investment company before the effective date of those regulations are subject to the provisions of §1.367(e)-2T, and any gain recognized is subject to the provisions of section 1291 *et seq.*

It is noted that this regulation does not impose a filing requirement under section 6038B for distributions under section 367(e).

SPECIAL ANALYSES

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It is hereby certified that these rules will not have a significant impact on a substantial number of small entities. Few small entities would be affected by these regulations. A regulatory flexibility analysis, therefore, is not required under the Regulatory Flexibility Act (5 U.S.C. chapter 6).

* * * * *

Amendments to the regulations

Accordingly, 26 CFR Parts 1, 7 and 602 are amended as follows:

INCOME TAX REGULATIONS

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805. *** Section 1.367(e)-1T is also issued under 26 U.S.C. 367(e)(1). Section 1.367(e)-2T is also issued under 26 U.S.C. 367(e)(2). ***

Par. 2. Section 1.367(a)-1T is amended by redesignating existing paragraph (e) as paragraph (g), and by adding the following new paragraphs (e) and (f).

§1.367(a)-1T Transfers to foreign corporations subject to section 367(a): In general (Temporary).

* * * * *

(e) *Close of taxable year in certain section 368(a)(1)(F) reorganizations.* If a domestic corporation is the transferor corporation in a reorganization described in section 368(a)(1)(F) after March 30, 1987, in which the acquiring corporation is a foreign corporation, then the taxable year of the transferor corporation shall end with the close of the date of the transfer and the taxable year of the acquiring corporation shall end with the close of the date on which the transferor's taxable year would have ended for the occurrence of the transfer. With regard to the consequences of the closing of the taxable year, see section 381 and the regulations thereunder.

(f) *Exchanges under sections 354(a) and 361(a) in certain section 368(a)(1)(F) reorganizations.* In every reorganization under section 368(a)(1)(F), where the transferor corporation is a domestic corporation and the acquiring corporation is a foreign corporation, there is considered to exist—

(1) A transfer of assets by the transferor corporation to the acquiring corporation under section 361(a) in exchange for stock of the acquiring corporation and the assumption by the acquiring corporation of the transferor corporation's liabilities:

(2) A distribution of the stock (or stock and securities) of the acquiring corporation by the transferor corporation to the shareholders (or shareholders and security holders) of the transferor corporation; and

(3) An exchange by the transferor corporation's shareholders (or shareholders and security holders) of the stock of the transferor corporation for stock (or stock and securities) of the acquiring corporation under section 354(a).

For this purpose, it shall be immaterial that the applicable foreign or

domestic law treats the acquiring corporation as a continuance of the transferor corporation.

* * * * *

Par. 3. The following new §§1.367(e)-0T, 1.367(e)-1T, and 1.367(e)-2T are added immediately after §1.367(d)-1T:

§1.367(e)-0T Treatment of Distributions or Liquidations Under Section 367(e); Table of Contents (Temporary).

This section lists captioned paragraphs contained in §§1.367(e)-1T through 1.367(e)-2T, temporary regulations under section 367(e) of the Internal Revenue Code.

§1.367(e)-1T Distributions described in section 367(e)(1) (Temporary).
(a) Purpose and scope.
(b) Recognition of gain required.
(1) General rule.
(2) Nonapplication of section 367 principles that provide for exceptions to gain recognition.
(c) Nonrecognition of gain.
(1) Distribution of certain U.S. real property holding corporation stock.
(2) Distribution of certain domestic stock.
(i) Conditions for nonrecognition.
(ii) Required statement.
(iii) Effect of submitting statement.
(iv) Priority of FIRPTA nonrecognition.
(3) Distribution of stock by a publicly traded corporation.
(i) Conditions for nonrecognition.
(ii) Relation to other nonrecognition provisions.
(d) Other consequences.
(1) Distributee basis in stock.
(2) Dividend treatment under section 1248.
(3) Exchange under section 897(e)(1).
(4) Distribution of stock of a passive foreign investment company.
(e) Examples.
(f) Effective date.

§1.367(e)-2T Distributions described in section 367(e)(2) (Temporary).
(a) Purpose and scope.
(1) In general.
(2) Nonapplicability of section 367(a).
(b) Distribution by a domestic corporation.
(1) Recognition of gain required.
(i) General rule.
(ii) Recognition of losses.
(iii) Distribution of partnership interest.
(A) In general.
(B) Basis adjustments.
(C) Limited partnership interest.
(2) Recognition of gain or loss not required.
(i) Distribution of property used in a United States trade or business.
(A) Conditions for nonrecognition.
(B) Required statement.
(C) Effect of submitting statement.
(ii) Distribution of U.S. real property interests.
(iii) Transitional rule for certain treaty provisions.
(3) Other consequences.
(i) Distributee basis in property.
(ii) Dividend treatment under section 1248.
(iii) Exchange under section 897 (e) (1).
(iv) Distribution of stock of a passive foreign investment company.
(v) Carryover of tax attributes.
(4) Examples.
(c) Distribution by a foreign corporation.
(1) Recognition of gain generally not required.
(2) Recognition of gain required.
(i) Property used in a United States trade or business.
(A) In general.
(B) Required statement.
(C) Effect of submitting or failing to submit a statement.
(ii) Property formerly used in a United States trade or business.
(3) Other consequences.
(i) Distributee basis in property.
(ii) Distribution under section 367 (b).
(iii) Distribution or exchange of U.S. real property interests.
(iv) Distribution of stock of a passive foreign investment company.
(v) Carryover of tax attributes.
(4) Examples.
(d) Effective date.

§1.367(e)-1T Distributions described in section 367(e)(1) (Temporary).

(a) *Purpose and scope.* This section provides rules concerning the recognition of gain by a domestic corporation (the "distributing corporation") on a distribution of stock or securities in a domestic or foreign corporation (the "controlled corporation") under section 355 to a person who is not a United States person. Paragraph (b) of this section states as a general rule that gain recognition is required on the distribution. Paragraph (c) of this section provides exceptions to the gain recognition rule of paragraph (b). Paragraph (d) of this section refers to other consequences of distributions described in this section. Paragraph (e) of this section provides examples of the rules of paragraphs (b), (c) and (d). Finally, paragraph (f) specifies the effective date for the rules of this section. The rules of this section are issued pursuant to the authority conferred by section 367(e)(1).

(b) *Recognition of gain required*—(1) *General rule.* If a domestic corporation makes a distribution of stock or securities of a domestic or foreign corporation to a person who is not a United States person as defined in §1.367(a)-1T(d)(1) (the "foreign distributee") in a distribution that qualifies under section 355(a), then, except as provided in paragraph (c) of this section, the distributing corporation shall recognize gain (but not loss) on the distribution under section 367(e)(1). The gain recognized by the distributing domestic corporation shall be equal to the excess of the fair market value of the stock or securities distributed to the foreign distributee (as of the time of the distribution) over such corporation's adjusted basis in the stock or securities distributed to the foreign distributee. For purposes of the preceding sentence, the distributing domestic corporation's adjusted basis in each unit of each class of stock or securities distributed

to a foreign distributee shall be equal to the corporation's total adjusted basis in all of the units of the respective class of stock or securities held immediately before the distribution, divided by the total number of units of such class of stock or securities held immediately before the distribution. If the distribution otherwise qualifies under section 355, each distributee of the distributing domestic corporation shall be considered to have received the distributed stock in such a distribution even though the distributing corporation recognizes gain on the distribution. Thus, the distributee does not receive a dividend upon the receipt of the stock of the controlled corporation.

(2) *Nonapplication of section 367 principles that provide for exceptions to gain recognition.* The rule of paragraph (b)(1) of this section requires recognition of gain notwithstanding the application of any principles contained in section 367 or the regulations thereunder that provide for exceptions to gain recognition. The only exceptions to the rule of paragraph (b)(1) of this section are contained in paragraph (c) of this section.

(c) *Nonrecognition of gain*—(1) *Distribution of certain U.S. real property holding corporation stock.* Gain shall not be recognized under paragraph (b)(1) of this section by a domestic corporation making a distribution of stock or securities of a domestic controlled corporation to a foreign distributee in a distribution that qualifies under section 355(a) if, immediately after the distribution, both the distributing and the controlled corporations are U.S. real property holding corporations (as defined in section 897(c)(2)). For the treatment of the distribution under section 897, see section 897(e) and §1.897-6T(a)(1) and (4).

(2) *Distribution of certain domestic stock*—(i) *Conditions for nonrecognition.* Gain shall not be recognized under paragraph (b)(1) of this section by a domestic corporation making a distribution of stock or securities of a domestic controlled corporation to a foreign distributee in a distribution that qualifies under section 355(a) if each of the following conditions is satisfied:

(A) Five or fewer persons, each of whom is either an individual or a corporation (or an entity treated as a corporation for U.S. tax purposes), directly own 100 percent of the outstanding stock (exclusive of directors' qualifying shares) of the distributing corporation immediately before the distribution.

(B) Immediately before the distribution, at least ninety percent (by value) of the aggregate outstanding stock of the distributing corporation has a holding period of at least two years in the hands of the persons described in paragraph (c)(2)(i)(A). Such holding period shall be determined under section 1223, except that for this purpose section 1223(2) shall only apply if such person acquired such stock in a transaction described in section 381.

(C) If the subject foreign distributee is a foreign corporation, the stock of the distributing corporation held by such foreign distributee immediately before the distribution has a fair market value that is less than 50 percent of the total fair market value of all of the outstanding stock of such foreign distributee immediately before the distribution. For purposes of the preceding sentence, the fair market value of the stock of the foreign distributee shall be determined without regard to any cash, cash items (such as bank deposits or receivables), or marketable securities held by the foreign distributee.

(D) Immediately before the distribution, all of the stock of the distributing corporation owned by the subject foreign distributee has a holding period of at least two years. Such holding period shall be determined under section 1223, except that for this purpose section 1223(2) shall only apply if such person acquired such stock in a transaction described in section 381.

(E) After the distribution, the subject foreign distributee is and continues to be a resident of (if such foreign distributee is an individual), or is incorporated in and continues to be incorporated in (if such foreign distributee is a corporation), a foreign country that maintains an income tax treaty with the United States that contains an information exchange provision.

(F) Immediately after the distribution, the stock of the distributing corporation has a fair market value that is at least equal to the fair market value of the distributed stock (or if stock and securities are distributed, the fair market value of the distributed stock and securities) of the controlled corporation immediately before the distribution.

(G) The separate corporate existence of the distributing corporation (or its domestic successor in a reorganization described in section 368(a)(1)(F)) is maintained for a period of five full taxable years (excluding short taxable years) beginning with the taxable year following the year of the distribution. A domestic successor shall be treated as the distributing corporation for purposes of this paragraph (c)(2) and shall, therefore, succeed to all of the responsibilities of the distributing corporation thereunder.

(H) No later than the last day of each of the five full taxable years of the distributing corporation (excluding short taxable years) after the taxable year of the distribution, the subject foreign distributee provides to the distributing corporation the certificate described in paragraph (c)(2)(ii)(F).

(I) The distributing and controlled corporations attach the statement described in paragraph (c)(2)(ii) of this section to their U.S. income tax returns for the taxable year that includes the distribution.

(ii) *Required statement.* The statement required by paragraph (c)(2)-(i)(I) of this section shall be prepared by or on behalf of the distributing corporation and signed under penalties of perjury by an authorized officer of each of the distributing corporation and the controlled corporation, and by each foreign shareholder of the distributing corporation that receives a distribution with respect to which nonrecognition is claimed under paragraph (c)(2). The statement shall set forth the following items:

(A) A declaration that the distribution is one to which the provisions and rules of section 1.367(e)-1T(c)(2) apply.

(B) A description of each shareholder of the distributing corporation (without regard to whether such shareholder is a United States person) including such shareholder's name, address, taxpayer identification num-

ber (if any), and residence and citizenship (in the case of an individual) or place of incorporation (in the case of a corporation). Such description must identify the shareholders that are foreign distributees of controlled corporation stock with respect to which there is a claim of nonrecognition under paragraph (c)(2).

(C) A description of the stock in the distributing corporation directly owned immediately before the distribution by each shareholder described in paragraph (c)(2)(ii)(B), including the number or amount of shares, the type of stock, the percentage (by value) that such stock represented of the total stock of the distributing corporation outstanding immediately before the distribution, the date on which such stock was directly acquired by such shareholder, and such shareholder's holding period in respect of such stock (determined according to the provisions of paragraph (c)(2)(i)(B)).

(D) A description of the stock of the distributing and controlled corporations directly owned immediately after the distribution by each shareholder described in paragraph (c)(2)(ii)(B), including the number or amount of shares, the type of stock, and the percentage (by value) that such stock represents of the total stock of the distributing or controlled corporation immediately after the distribution. In the case of the distribution to a foreign distributee of controlled corporation stock with respect to which there is a claim of nonrecognition under paragraph (c)(2), the description must also include the fair market value of such stock at the time of its distribution, a summary of the method (including appraisals, if any) used for determining such value, and the distributing corporation's adjusted basis in such stock immediately prior to the distribution (computed according to the provisions of paragraph (b)(1) of this section).

(E) A declaration of the total fair market value of the stock of the distributing corporation immediately after the distribution, the total fair market value of the distributed stock (or, if stock and securities are distributed, the fair market value of the distributed stock and securities) of the controlled corporation immediately before the distribution, and a summary of the method (including appraisals, if any) used for determining such values.

(F) A declaration by the distributing corporation and each foreign distributee of controlled corporation stock with respect to which nonrecognition is claimed under paragraph (c)(2) that, no later than the last day of each of the five full taxable years of the distributing corporation after the taxable year of the distribution, such distributee will certify to the distributing corporation, in writing and under penalties of perjury, that as of the certification date (*1*) such shareholder directly owns all of the stock of the distributing and controlled corporations directly owned by such person immediately after the distribution and all of the stock of the distributing and controlled corporations acquired from either of the corporations since the distribution, and (*2*) such shareholder has directly owned all of such stock without interruption since the date of the distribution or acquisition.

(G) A declaration by the distributing corporation that it shall attach the annual certifications described in the preceding subdivision (F) to its U.S. income tax return for each year during the prescribed five full taxable year period.

(H) A declaration that the distributing corporation agrees to extend the statute of limitations on assessments and collections (under section 6501) with respect to the distribution of the stock and securities of the controlled corporation until 3 years after the filing of its return for the fifth full taxable year following the taxable year that includes the distribution.

(iii) *Effect of submitting statement.* By claiming nonrecognition under this paragraph (c)(2), the distributing corporation agrees to be subject to the rules of this paragraph (c)(2)(iii).

(A) If (*1*) a foreign distributee with respect to whose stock there is a claim of nonrecognition under paragraph (c)(2) does not provide to the distributing corporation an annual certificate described in paragraph (c)(2)(ii)(F), or (*2*) the distributing corporation knows or has reason to know that such foreign distributee has ceased to own directly (other than by reason of an individual foreign distributee's death) all of the stock or securities in the distributing and controlled corporations described in the certificate prior to the end of the fifth full taxable year of the distributing corporation following the distribution, then the distributing corporation shall file an amended U.S. income tax return for the year of the distribution and recognize all of the gain realized on the distribution of stock and securities to such foreign distributee. Such amended return shall be filed no later than 60 days after the failure to file a certificate, or 60 days after the distributing corporation knows or has reason to know that the requisite direct ownership has ceased.

(B) If the separate corporate existence of the distributing corporation is not maintained as provided in paragraph (c)(2)(i)(G), then the distributing corporation shall file an amended U.S. income tax return for the year of the distribution and shall recognize the gain realized on the distribution of all of the controlled corporation stock or securities with respect to which there was a claim of nonrecognition under paragraph (c)(2) and with respect to which an amended return has not previously been filed under paragraph (c)(2)(iii)(A). Such amended return shall be filed no later than 60 days after adoption of a resolution or agreement providing for the liquidation or other termination or dissolution of the distributing corporation.

(C) If additional tax is required to be paid by the distributing corporation for the year of the distribution, then interest must be paid by the distributing corporation on that amount at the rates determined under section 6621 with respect to the period between the date that was prescribed for filing the distributing corporation's original U.S income tax return for the year of the distribution and the date on which the additional tax for that period is paid.

(iv) *Priority of FIRTPA nonrecognition.* If the distribution of the stock and securities of the controlled corporation also qualifies for nonrecognition under paragraph (c)(1), then the distributing corporation shall be entitled to nonrecognition under paragraph (c)(1) and not under this paragraph (c)(2).

(3) *Distribution of stock by a publicly traded corporation*—(i) *Condi-*

tions for nonrecognition. Gain shall not be recognized under paragraph (b)(1) of this section by a domestic corporation making a distribution of stock or securities of a domestic controlled corporation to a foreign distributee in a distribution that qualifies under section 355(a) if each of the following conditions is satisfied:

(A) Classes of stock of the distributing corporation that are regularly traded on an established securities market, as defined in §1.897-1(m)(1) and (3), located in the United States represent at least 80 percent of the total value of all classes of outstanding stock of the distributing corporation. Stock is considered to be regularly traded if it is regularly quoted by brokers or dealers making a market in such interests. A broker or dealer is considered to make a market only if the broker or dealer holds himself out to buy or sell interests in the stock at the quoted price.

(B) Stock of the domestic controlled corporation with a value of more than 80 percent of the outstanding stock of such corporation is distributed with respect to one or more of the classes of the outstanding stock of the distributing corporation that are regularly traded on an established securities market.

(C) The distributing corporation does not know or have reason to know that the subject foreign distributee owns, directly or indirectly, more than five percent (by value) of the shares in the class of the distributing corporation stock with respect to which the stock of the domestic controlled corporation is distributed. For example, a corporation that has received a notice pursuant to the rules or regulations of the Securities and Exchange Commission that a foreign shareholder owns six percent of the class of its stock, with respect to which there is a distribution, knows that such foreign distributee owns more than five percent of such class of stock.

(ii) *Relation to other nonrecognition provisions.* If the distribution of the stock and securities of the controlled corporation also qualifies for nonrecognition under paragraph (c)(1), then the distributing corporation shall be entitled to nonrecognition under paragraph (c)(1) and not under this paragraph (c)(3).

(d) *Other consequences*—(1) *Distributee basis in stock.* Except where §1.897-6T(a)(4) causes gain recognition by the distributee, the basis of the distributed domestic or foreign corporation stock in the hands of the distributee who is not a United States person shall be the basis of the distributed stock determined under section 358 without any increase for any gain recognized by the domestic corporation on the distribution.

(2) *Dividend treatment under section 1248.* With respect to the treatment as a dividend of a portion of the gain recognized by the domestic corporation on the distribution of the stock of certain foreign corporations, see section 1248(a) and the regulations thereunder.

(3) *Exchange under section 897(e)(1).* With respect to the treatment under section 897(e)(1) of a foreign distributee on the receipt of stock or securities in a domestic or foreign corporation where the foreign distributee's interest in the distributing domestic corporation is a United States real property interest, see section 897(e)(1) and §1.897-6T(a)(1) and (4).

(4) *Distribution of stock of a passive foreign investment company.* [RESERVED]

(e) *Examples.* The rules of paragraphs (b), (c), and (d) of this section may be illustrated by the following examples.

Example (1). (i) FC, a Country X corporation, owns all of the outstanding stock of DC1, a domestic corporation, that owns all of the outstanding stock of DC2, a domestic corporation. The fair market value of the DC1 stock is 300x, and FC has a basis in the DC1 stock of 100x. The fair market value of the DC2 stock is 180x, and DC1 has a basis in the DC2 stock of 40x. Neither DC1 nor DC2 is a U.S. real property holding corporation. Country X does not maintain an income tax treaty with the United States.

(ii) In a transaction qualifying as a distribution of stock of a controlled corporation under section 355(a), DC1 distributes all of the stock of DC2 to FC. After the distribution, the DC1 stock has a fair market value of 120x.

(iii) Under paragraph (b)(1) of this section, DC1 recognizes gain of 140x, which is the difference between the fair market value (180x) and the basis (40x) of the stock distributed. Under paragraph (d)(1) of this section and section 358, FC takes a basis of 40x in the DC1 stock, and a basis of 60x in the DC2 stock.

Example (2). (i) C, a citizen and resident of Country F, owns all of the stock of DC, a U.S. real property holding corporation. The fair market value of the DC stock is 500x, and C has a basis in the DC stock of 100x.

(ii) In a transaction qualifying as a distribution of stock of a controlled corporation under section 355(a), DC distributes to C all of the stock of FC, a foreign corporation that is not a passive foreign investment company. FC is not a U.S. real property holding corporation and has not made an election under section 897(i) to be treated as a domestic corporation for purposes of section 897. The FC stock has a fair market value of 200x, and DC has a basis in the FC stock of 180x. After the distribution, the DC stock has a fair market value of 300x.

(iii) Under paragraph (b) of this section, DC recognizes gain of 20x which is the difference between the fair market value (200x) and the basis (180x) of the stock distributed. In regard to the treatment of DC under section 1248, see section 1248(a) and the regulations thereunder.

(iv) Under section 897(e) and §1.897-6T(a)(4), C is considered to have exchanged DC stock with a fair market value of 200x and an adjusted basis of 40x for FC stock with a fair market value of 200x. Because FC is not a U.S. real property holding corporation, and its stock is not a U.S. real property interest, C must recognize gain of 160x under section 897(a) on the distribution. C takes a basis of 200x in the FC stock because there is a recognition exchange under the rules of §1.897-6T(a)(4). C's basis in the DC stock is reduced to 60x pursuant to section 358.

Example (3). (i) Assume the same facts as in Example (2), except that (instead of FC stock) stock of DC2, a domestic corporation, is distributed to C, and that DC and DC2 are U.S. real property holding corporations immediately after the distribution.

(ii) Under paragraph (c)(1) of this section, DC does not recognize gain on the distribution of the DC2 stock because DC and DC2 are U.S. real property holding corporations immediately after the distribution.

(iii) Under section 897(e) and §1.897-6T(a)(4), C is considered to have exchanged DC stock with a fair market value of 200x and an adjusted basis of 40x for DC2 stock with a fair market value of 200x. Because DC2 is a U.S. real property holding corporation, and its stock is a U.S. real property interest, C does not recognize any gain under section 897(e) on the distribution. C takes a basis of 40x in the DC2 stock, and its basis in the DC stock is reduced to 60x pursuant to section 358.

Example (4). (i) C, a citizen and resident of Country F, has owned all of the stock of DC1, a domestic corporation, for six years. The fair market value of the DC1 stock is 800x, and C has a basis in the DC1 stock of 600x. Country F maintains an income tax treaty with the United States that includes an information exchange provision.

(ii) In a transaction qualifying as a distribution of stock of a controlled corporation under section 355(a), DC1 distributes to C all of the stock of DC2, a domestic corporation. The DC2 stock has a fair market value of 200x, and DC1 has a basis in the DC2 stock of 100x. After the distribution, the DC1 stock has a fair market value of 600x. C will continue to be a resident of Country F after the distribution. The separate corporate existence of DC1 will be maintained for a period of at least five full taxable years beginning with the taxable year following the year of the distribution, with C as the sole shareholder.

(iii) Under paragraph (c)(2) of this section, DC1 does not recognize gain on the distribu-

tion of the DC2 stock if DC1, DC2, and C comply with all of the provisions of paragraph (c)(2) of this section. C takes a basis of 150x in the DC2 stock, and C's basis in the DC1 stock is reduced to 450x pursuant to section 358.

Example (5). (i) All of the outstanding common stock of DC, a domestic corporation, is regularly traded on an established securities market located in the United States. No other stock of DC is outstanding. None of the foreign shareholders of DC, directly or indirectly, owns more than five percent of the common stock of DC.

(ii) In a transaction qualifying as a distribution of stock of a controlled corporation under section 355(a), DC distributees all of the stock of DS, a domestic corporation, to the common shareholders of DC. The stock of DS has appreciated in the hands of DC.

(iii) Under paragraph (c)(3) of this section, DC does not recognize gain on the distribution of the DS stock to any foreign distributee because the requirements of that paragraph have been met. The basis of the shareholders in the DC and DS stock is determined pursuant to section 358.

(f) *Effective date.* This section shall be effective for distributions occurring after February 15, 1990.

§1.367(e)-2T Distributions described in section 367(e)(2) (Temporary).

(a) *Purpose and scope*—(1) *In general.* This section provides rules concerning the recognition of gain by a corporation on its distribution to a foreign corporation of property in a complete liquidation to which section 332 applies. Paragraph (b)(1) of this section states as a general rule that gain recognition is required when a domestic corporation makes a distribution of property in complete liquidation under section 332 to a foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in the domestic corporation. Paragraph (b)(2) of this section provides the only exceptions to the gain recognition rule of paragraph (b)(1). Paragraph (b)(3) of this section refers to other consequences of distributions described in paragraphs (b)(1) and (2). Paragraph (c)(1) of this section states as a general rule that gain recognition is not required when a foreign corporation makes a distribution of property in complete liquidation under section 332 to another foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in the distributing foreign corporation. Paragraph (c)(2) of this section provides exceptions to the nonrecognition rule of paragraph (c)(1). Paragraph (c)(3) of this section refers to other consequences of distributions described in paragraphs (c)(1) and (2). Examples of the rules of this section are provided in paragraphs (b)(4) and (c)(4) of this section. Finally, paragraph (d) specifies the effective date for the rules of this section. The rules of this section are issued pursuant to the authority conferred by section 367(e)(2).

(2) *Nonapplicability of section 367(a).* Section 367(a) shall not apply to a complete liquidation described in section 332 by a domestic corporation into a foreign corporation that meets the stock ownership requirements of section 332(b) and that is subject to section 367(e)(2) or is described in paragraph (b)(2)(iii) of this section.

(b) *Distribution by a domestic corporation*—(1) *Recognition of gain required*—(i) *General rule.* If a domestic corporation makes a distribution of property in a complete liquidation under section 332 to a foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in the domestic corporation, then, except as provided in paragraph (b)(2) of this section, section 337(a) and (b)(1) shall not apply and the distributing domestic corporation shall recognize gain on the distribution of the item of property under section 367(e)(2). The gain recognized by the domestic corporation shall be equal to the excess of the fair market value of each such item of property distributed over its adjusted basis. Except as provided in paragraphs (b)(2)(iii) and (d) of this section, the recognition of gain required under this paragraph is not prohibited by any treaty to which the United States is a party.

(ii) *Recognition of losses.* If paragraph (b)(1)(i) of this section would apply to a distribution of an item of property but for the fact that the distributing domestic corporation realizes a loss on the distribution of such item of property, then the distributing domestic corporation shall recognize the loss realized on such distribution. However, such loss shall be recognized only to the extent that (A) the total amount of capital losses recognized on such distributions does not exceed the total amount of capital gains recognized by the distributing domestic corporation pursuant to paragraph (b)(1)(i), and (B) the total amount of ordinary losses recognized on such distributions does not exceed the total amount of ordinary income recognized by the distributing domestic corporation pursuant to paragraph (b)(1)(i). Notwithstanding any other provision of this paragraph, losses shall be recognized under this section only on property that the distributing domestic corporation did not acquire within the five year period ending on the date of the liquidation through a capital contribution, a liquidation under section 332, or an exchange under section 351(a) or 361(a). If, pursuant to the rules of this paragraph (b)(1)(ii), only a portion of the capital loss or ordinary loss on the property distributed is recognized because the aggregate capital loss exceeds the aggregate capital gain or the aggregate ordinary loss exceeds the aggregate ordinary gain of the distributing corporation, then the capital loss (and the ordinary loss) recognized shall be treated as being recognized on a pro rata basis with respect to each such capital or ordinary property distributed.

(iii) *Distribution of partnership interest*—(A) *In general.* If a domestic corporation distributes an interest as a partner in a partnership (whether foreign or domestic) in a distribution described in paragraph (b)(1)(i) of this section, then for purposes of applying this section the domestic corporation shall be treated as having distributed a proportionate share of the property of the partnership. Accordingly, the applicability of the nonrecognition rules of paragraph (b)(1)(i) and (ii) and of any exception to recognition provided in this section shall be determined with reference to the property of the partnership rather than to the partnership interest itself. Where the property of the partnership includes an interest in a lower-tier partnership the applicability of any exception with respect to the interest in the lower-tier partnership shall be determined with reference to the property of the lower- tier partnership. In the case of multiple tiers of partnerships, the applicability of an exception shall be determined with reference to the property of the lowest-tier partnership in the partnership chain. A domestic corporation's proportionate share of partnership property shall be determined under the rules and principles of sections

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701 through 761 and the regulations thereunder.

(B) *Basis adjustments.* The foreign corporation's basis in the distributed partnership interest shall be equal to the distributing domestic corporation's basis in such partnership interest immediately prior to the distribution, increased by the amount of gain and reduced by the amount of loss recognized by the domestic corporation on the distribution of the partnership interest. Solely for purposes of sections 743 and 754, the foreign corporation shall be treated as having purchased the partnership interest for an amount equal to the foreign corporation's adjusted basis therein.

(C) *Limited partnership interest.* The distribution by a domestic corporation of a limited partnership interest that is regularly traded on an established securities market shall not be subject to the rules of this paragraph (b)(1)(iii). Instead, the distribution of such an interest shall be treated in the same manner as a distribution of stock. For purposes of this section, a limited partnership interest is an interest as a limited partner in a partnership that is organized under the laws of any state of the United States or the District of Columbia. Whether such an interest is regularly traded on an established securities market shall be determined under the provisions of §1.367(a)-1T(c)(3)(ii)(D).

(2) *Recognition of gain or loss not required*—(i) *Distribution of property used in a United States trade or business*—(A) *Conditions for nonrecognition.* The domestic corporation shall not recognize gain or loss under paragraph (b)(1) of this section on its distribution of property (including inventory) used by the domestic corporation in the conduct of a trade or business within the United States if—

(*1*) The distributee foreign corporation is not a controlled foreign corporation, as defined in section 957(a) or section 953(c) (including a corporation that would be treated as a controlled foreign corporation under section 953(c) but for the provisions of section 953(c)(3)), at the time of the distribution of property;

(*2*) The distributee foreign corporation, for the ten-year period beginning on the date of the distribution of such property, uses the property in the conduct of a trade or business in the United States (or, in the case of inventory, continues to hold the property for sale to customers until disposed of); and

(*3*) The domestic and foreign corporations attach the statement described in paragraph (b)(2)(i)(B) to their U.S. income tax returns for the year of the distribution (or to an amended return filed no later than July 16, 1990).

This nonrecognition rule does not apply to the distribution of intangibles described in section 936(h)(3)(B). Property is considered used by a foreign corporation in the conduct of a trade or business in the United States only if any income from the use of the property and any income or gain from the sale or exchange of the property would be subject to taxation under section 882(a) as effectively connected income. For purposes of this paragraph (b)(2)(i)(A), stock held by a dealer as inventory or for sale in the ordinary course of its trade or business shall be treated as inventory and not as stock in the hands of both the domestic corporation and the distributee foreign corporation. If a distributing domestic corporation that would otherwise qualify for nonrecognition on the distribution of such property under this paragraph (b)(2)(i) fails to file the statement properly or files a statement that does not comply with the requirements of paragraph (b)(2)(i)(B) of this section, the Commissioner may, nevertheless, in his discretion treat the distributing domestic corporation as if it had, in fact, met all the requirements of paragraph (b)(2)(i)(B) if such treatment is necessary to prevent the taxpayer from otherwise deriving a tax benefit by such failure.

(B) *Required statement.* The statement required by paragraph (b)(2)(i)(A) shall be prepared by the distributing domestic corporation and signed under penalties of perjury by an authorized officer of each of the distributing domestic and distributee foreign corporations. The statement shall set forth the following items:

(*1*) A declaration that the distribution to the foreign corporation is one to which the rules of §1.367(e)-2T(b)(2)(i) apply.

(*2*) A description of all of the property distributed by the domestic corporation (whether or not the property qualifies for nonrecognition). Such description shall identify the property that continues to be used by the distributee foreign corporation in the conduct of a trade or business within the United States, including the location, adjusted basis, estimated fair market value, a summary of the method (including appraisals if any) used for determining such value, and the date of distribution of such items of property.

(*3*) An identification of the distributee foreign corporation, including its name and address, taxpayer identification number (if any), residence and place of incorporation.

(*4*) With respect to property entitled to nonrecognition pursuant to paragraph (b)(2)(i), a declaration by the distributee foreign corporation that it irrevocably waives any right under any treaty (whether or not currently in force at the time of the liquidation) to sell or exchange any item of such property without U.S. income taxation or at a reduced rate of taxation, or to derive income from the use of any item of such property without U.S. income taxation or at a reduced rate of taxation.

(*5*) An agreement by the distributing domestic corporation and the distributee foreign corporation to extend the statute of limitations on assessments and collections (under section 6501) with respect to the distribution of each item of property until three years after the date on which all such items of property have ceased to be used in a trade or business within the United States pursuant to paragraph (b)(2)(i)(C)(*1*), but in no event shall the extension be for a period longer than 13 years from the filing of the original U.S. income tax return for the taxable year of the last distribution of any such item of property. If, however, the distributing domestic corporation files an amended return pursuant to the provisions of paragraph (b)(2)(i)(C), other than an amended return filed for the substitution of property exchanged under section 1031 or converted under section 1033, the agreement to extend the statute of limitations on assessments and collections as to the property with respect to which gain is included on the amended return will not extend beyond three years (except as otherwise provided by section 6501) after the filing of the amended tax return.

(C) *Effect of submitting statement.* By the distributing domestic corporation's claiming nonrecognition under this paragraph (b)(2)(i), the distributing domestic corporation and the distributee foreign corporation agree to be subject to the rules of this paragraph (b)(2)(i)(C).

(*1*) If, within the ten year period from the date of distribution, any item of property entitled to nonrecognition under paragraph (b)(2)(i)(A) ceases to be used by the distributee foreign corporation in the conduct of a trade or business in the United States for any reason (including but not limited to the sale or exchange of such property or the removal of the property from conduct of the trade or business), then, except as provided in paragraph (b)(2)(i)(C)(*3*), the distributee foreign corporation shall cause to be filed on behalf of the domestic corporation an amended U.S. income tax return for the year of the distribution of such item of property, in which return the domestic corporation recognizes the gain (but not loss) realized but not recognized upon the initial distribution of such item of property. On the amended return filed pursuant to paragraph (b)(2)(i)(C)(*1*), the distributing domestic corporation may use any losses (or credits) existing in the year of the distribution, that were otherwise available in that year and not used in another year, to offset the gain (or tax thereon) required to be recognized under such paragraph.

(*2*) The amended return required by paragraph (b)(2)(i)(C)(*1*) shall be filed no later than the due date (including extensions) for the return of the distributee foreign corporation for the taxable year in which the property ceases to be used by the distributee foreign corporation in the conduct of a trade or business in the United States.

(*3*) If property ceases to be used by the distributee foreign corporation in the conduct of a trade or business in the United States by reason of a disposition of such property, and either (*i*) a loss is recognized in whole on such disposition, or (*ii*) a gain is recognized in whole and the distributee foreign corporation reports the full amount of such gain on its timely filed U.S. tax return for the year of the disposition, then the distributing domestic corporation shall not be required to recognize any gain in respect of the distribution of such property on an amended return for the year of the distribution. If a gain is recognized in whole on the disposition of the property and the distributee foreign corporation does not report the full amount of such gain on a timely filed U.S. tax return for the year of the disposition, then the distributing domestic corporation shall be required to recognize and include in income on an amended return for the year of the distribution the full amount of gain realized by such domestic corporation on the distribution of such property. If the domestic corporation is required to recognize gain in the year of the distribution, the foreign corporation shall, nonetheless, be required to recognize any gain realized on the disposition of the property according to generally applicable principles, but the basis of the property in the hands of the foreign corporation shall be adjusted to reflect the recognition of gain by the domestic corporation. Thus, if the property ceases to be used in the active conduct of a trade or business in the United States in a transaction in which gain is recognized, and the distributee foreign corporation includes in income the full amount of such gain on a timely filed return for the taxable year in which gain is recognized, then no amended return shall be required to be filed in respect of such property by the distributing domestic corporation.

(*4*) For purposes of this paragraph (b)(2)(i)(C), property shall not be considered as no longer used in the conduct of a trade or business in the United States if exchanged for, or involuntarily converted into, similar property used in the conduct of a trade or business in the United States, to the extent such exchange or conversion qualifies for nonrecognition under section 1031 or 1033, or distributed to another foreign corporation in a liquidation distribution under section 337(a) qualifying for nonrecognition under paragraph (c)(2)(i) of this section. Further, a cessation of use of property in the conduct of a trade or business in the United States shall not include the abandonment or disposal of essentially worthless or obsolete property. If the distributee foreign corporation exchanges the property under section 1031 for, or converts the property under section 1033 into similar property used in the conduct of a trade or business in the United States, then the domestic corporation and the distributee foreign corporation must file amended returns for the year of the distribution of such property from the domestic corporation to the distributee foreign corporation, in order to substitute on the statement that was required by paragraph (b)(2)(i)(B) the property received in place of the property exchanged or converted. If the distributee foreign corporation distributes the property in a liquidation distribution under section 337(a) qualifying for nonrecognition under paragraph (c)(2)(i), then the rules of such paragraph shall apply to the distribution.

(*5*) If additional tax is required to be paid by the distributing corporation for the year of a liquidating distribution, then interest must be paid on that amount at the rates determined under section 6621 with respect to the period between the date that was prescribed for filing the distributing domestic corporation's U.S. income tax return for the year of the distribution and the date on which the additional tax for that year is paid.

(*6*) The distributee foreign corporation, as successor in interest and liability to the distributing domestic corporation, shall be jointly and severally liable for any tax owed by the distributing domestic corporation as a result of the application of paragraph (b)(2)(i), and shall succeed to the distributing domestic corporation's agreement to extend the statute of limitations and collections under section 6561.

(*7*) The distributee foreign corporation shall attach a statement to its U.S. income tax return for each year after the liquidation of the distributing domestic corporation. The statement shall identify the distributed property that ceased to be used by the distributee foreign corporation in the conduct of a trade or business within the United States during that year (without regard to whether the distributing domestic corporation was required to file an amended return as a result of such disposition pursuant to paragraph (b)(2)(i)(C)(*3*) of this section). The requirement to attach such statement to the return shall not

apply to any taxable year of the distributee foreign corporation after the final taxable year in which any distributed property is used by such corporation in the conduct of a trade or business within the United States, and in no event shall the requirement apply to a taxable year later than 13 years from the filing of the original U.S. income tax return for the taxable year of the distribution.

(ii) *Distribution of U.S. real property interests.* The domestic corporation shall not recognize gain under paragraph (b)(1) of this section on the distribution of a U.S. real property interest (other than stock in a former U.S. real property holding corporation which is treated as a U.S. real property interest for five years under §1.897-5T(c)(1)) in a complete liquidation under section 332(a) to the distributee foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in the distributing domestic corporation. See §1.897-5T(b)(3)-(iv)(A). If property distributed by the domestic corporation is a U.S. real property interest that qualifies for nonrecognition under this paragraph (b)(2)(ii) in addition to nonrecognition provided by paragraph (b)(2)(i) of this section, then the distributing domestic corporation shall secure nonrecognition pursuant to this paragraph (b)(2)(ii) and not pursuant to the provisions of paragraph (b)(2)(i).

(iii) *Transitional rule for certain treaty provisions.* A distributing domestic corporation shall not recognize gain or loss under paragraph (b)(1) of this section on the distribution of property in a complete liquidation under section 332(a) to a foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in the domestic corporation if—

(A) Such property was distributed by the domestic corporation and received by the foreign corporation after July 31, 1986, and before September 29, 1987 in a distribution that would have been subject to section 367(e)(2) (as enacted by the Tax Reform Act of 1986) but for the provisions of Notice 87-5, 1987-1 C.B. 416, and

(B) The foreign corporation is a resident of a foreign country which had an income tax treaty with the United States in force at the time of the distribution which contained a provision barring discrimination based on capital ownership and the corporation is not denied the benefit of nondiscrimination under that treaty.

See Notice 87-66, 1987-2 C.B. 376.

(3) *Other consequences*—(i) *Distributee basis in property.* The basis of property distributed pursuant to paragraph (b) of this section in the hands of the distributee foreign corporation shall be the basis of such property in the hands of the distributing domestic corporation, increased by the amount of gain (if any), or reduced by the amount of loss (if any), recognized by the domestic corporation on the distribution of each of the respective properties pursuant to paragraph (b)(1) of this section.

(ii) *Dividend treatment under section 1248.* With respect to the treatment as a dividend of a portion of the gain recognized by the domestic corporation on the distribution of the stock of certain domestic and foreign corporations, see section 1248(a) and (e) and the regulations thereunder. With respect to the treatment as a dividend of a portion of the gain realized but not otherwise recognized under paragraph (b)(1) of this section by the domestic corporation on the distribution of the stock of a foreign corporation (including a foreign corporation, the stock of which is a U.S. real property interest, because such corporation has in effect a valid election under section 897(i)), see section 1248(f) and the regulations thereunder.

(iii) *Exchange under section 897(e)(1).* With respect to the treatment under section 897(e)(1) of a distributee foreign corporation whose interest in the distributing domestic corporation is a U.S. real property interest, see §1.897-5T(b)(3)(iv)(A).

(iv) *Distribution of stock of a passive foreign investment company.* [RESERVED]

(v) *Carryover of tax attributes.* In regard to the carryover of certain tax attributes from the domestic corporation to the distributee foreign corporation, see section 381 and the regulations thereunder.

(4) *Examples.* The rules of this paragraph (b) may be illustrated by the following examples.

Example (1). (i) FC, a Country X corporation, owns all of the outstanding stock of DC, a domestic corporation. All of the property of DC has appreciated in value and is used in the conduct of a trade or business in Country X. None of the DC property is used in connection with the conduct of a trade or business within the United States. In a liquidation under section 332, DC distributes all of its property to FC.

(ii) Under paragraph (b)(1) of this section, DC recognizes gain on the distribution of its property to FC. FC takes a basis in each property equal to DC's basis in the property increased by the amount of any gain recognized by DC on the distribution of the property.

Example (2). (i) FC, a Country X corporation that is not a controlled foreign corporation, owns all of the outstanding stock of DC, a domestic corporation. DC owns Parcel P (a U.S. real property interest), equipment used in the conduct of a trade or business in the United States, and all of the stock in DC1, a domestic corporation, and FS, a foreign corporation that is not a passive foreign investment company. All of the property has appreciated in value since acquired by DC. DC, DC1, and FS have never been U.S. real property holding corporations.

(ii) DC distributes all of its property to FC in complete liquidation under section 332 on March 1, 1988. Beginning immediately after the distribution of the equipment, FC uses the equipment in the conduct of a trade or business in the U.S.

(iii) Under paragraph (b)(2)(ii) of this section, DC does not recognize gain on the distribution of Parcel P. If DC and FC comply with the requirements of paragraph (b)(2)(i) of this section, DC will not recognize gain on the distribution of the equipment, because FC uses the equipment in the conduct of a U.S. trade or business immediately after the distribution. DC must recognize gain pursuant to paragraph (b)(1) of this section on the distribution of the stock of DC1 and FS because there is no exception from gain recognition for the liquidating distribution of stock that is not held by the distributing corporation for sale to customers in the ordinary course or as inventory unless the corporation the stock of which is being distributed is a U.S. real property holding corporation. In regard to the treatment of DC under section 1248, see, however, section 1248(a) and (e) and the regulations thereunder.

(iv) FC takes DC's basis under paragraph (b)(3)(i) of this section in Parcel P and the equipment because no gain is recognized by DC on the distribution of that property. Under paragraph (b)(3)(i) of this section, FC takes DC's basis in the stock of DC1 and FS, increased by the amount of the gain recognized by DC on the respective stocks.

(c) *Distribution by a foreign corporation*—(1) *Recognition of gain generally not required.* If a foreign corporation makes a distribution of property in complete liquidation under section 332 to another foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in the distribut-

ing foreign corporation, then, except as provided in paragraph (c)(2) of this section, section 337(a) and (b)(1) shall apply and the distributing foreign corporation shall not recognize gain (or loss) on the distribution under section 367(e)(2). If a distributing foreign corporation distributes an interest as a partner in a partnership (whether foreign or domestic), then such corporation shall be treated as having distributed a proportionate share of the property of the partnership in accordance with the principles of paragraph (b)(1)(iii) of this section.

(2) *Recognition of gain required*—(i) *Property used in a United States trade or business*—(A) *In general.* A foreign corporation (including a corporation that has made an effective election under section 897(i)) that makes a distribution of property in complete liquidation under section 332 to another foreign corporation that meets the stock ownership requirements of section 332(b) with respect to the stock in the distributing foreign corporation shall recognize gain on the distribution of any property (other than U.S. real property interests) used by the distributing foreign corporation at the time of the liquidation in the conduct of a trade or business within the United States unless the distributee foreign corporation for a ten-year period continues to use such property in the conduct of a trade or business within the United States, and the distributing and distributee foreign corporations attach the statement described in paragraph (c)(2)(i)(B) to their U.S. income tax returns for their taxable years that include the distribution. However, this paragraph (c)(2)(i)(A) shall not apply if all of the following conditions exist.

(*1*) At the time of the distribution, the distributing and the distributee foreign corporations are controlled foreign corporations as defined in section 957(a) or section 953(c) (including a corporation that would be treated as a controlled foreign corporation under section 953(c) but for the provisions of section 953(c)(3));

(*2*) The distributee foreign corporation uses such property in the conduct of a trade or business within the United States immediately after the distribution;

(*3*) There was no prior liquidation subject to section 367(e)(2) of a corporation into the distributing corporation (or a predecessor corporation) under paragraph (b)(2)(i) or this paragraph (c)(2)(i) (other than a controlled foreign corporation into another controlled foreign corporation); and

(*4*) The distributee foreign corporation is not entitled to benefits under a comprehensive income tax treaty, but if the distributing foreign corporation (or predecessor corporation) was entitled to benefits under a comprehensive income tax treaty, then the distributee foreign corporation may (but need not) be entitled to benefits under a comprehensive income tax treaty.

(*B*) *Required statement.* The statement required by paragraph (c)(2)(i)(A) shall be prepared by or on behalf of the distributing foreign corporation and signed under penalties of perjury by an authorized officer of each of the distributing and distributee foreign corporations, and shall be identical to the statement described in paragraph (b)(2)(i)(B), except that "§1.367(e)-2T(c)(2)(i)" shall be substituted for references to "§1.367(e)-2T(b)(2)(i)" and the term "distributing foreign corporation" shall be substituted for either the term "domestic corporation" or the term "distributing domestic corporation" each time it appears. References in the rules of paragraph (b)(2)(i)(B) to various rules in paragraph (b) shall be aplied as if such references were to this paragraph (c). However, the distributee foreign corporation shall not be required to waive its income tax treaty benefits as required by §1.367(e)-2T(b)(2)(i)(B)(*4*) unless the distributing foreign corporation was required to waive its treaty benefits under paragraph (b)(2)(i)(B)(*4*) of this section in connection with the distribution of such property in a prior liquidation distribution subject to the provisions of this section; the distributee foreign corporation is entitled to benefits under a treaty to which the distributing foreign corporation was not entitled; or the distributee foreign corporation is incorporated in a country different from the country in which the distributing foreign corporation is incorporated.

(*C*) *Effect of submitting or failing to submit a statement.* By the distributing foreign corporation's claiming nonrecognition under this paragraph (c)(2)(i), the distributing foreign corporation and the distributee foreign corporation agree to be subject to the rules of this paragraph (c)(2)(i) and the rules of paragraph (b)(2)(i)(C). In applying the rules of paragraph (b)(2)(i)(C), the term "distributing foreign corporation" shall be substituted for either the term "domestic corporation" or the term "distributing domestic corporation" each time it appears. References in the rules of paragraph (b)(2)(i)(C) to various rules in paragraph (b) shall be applied as if such references were to this paragraph (c). However, if a distributing foreign corporation that would otherwise qualify for nonrecognition on the distribution of such property under this paragraph (c)(2)(i) fails to file the statement properly or files a statement that does not comply with the requirements of this paragraph, the Commissioner may, nevertheless, in his discretion treat the distributing foreign corporation as if it had, in fact, met all the requirements of this paragraph if such treatment is necessary to prevent the taxpayer from otherwise deriving a tax benefit by such failure.

(ii) *Property formerly used in a United States trade or business.* A foreign corporation making a distribution of property in complete liquidation under section 332 to another foreign corporation that meets the stock ownership requirements of section 332(b) with respect to stock in the distributing foreign corporation shall recognize gain (but not loss) on the distribution of any property (other than U.S. real property interests) that ceased, in a taxable year beginning after December 31, 1986, and within ten years prior to the date of liquidation, to be used in connection with the conduct of a trade or business within the United States. Section 864(c)(7) shall govern the treatment of any gain recognized on the distribution of assets described in this paragraph as income effectively connected with the conduct of a trade or business within the United States.

(3) *Other consequences*—(i) *Distributee basis in property.* The basis of distributed property in the hands of

the distributee foreign corporation shall be the basis of the distributed property in the hands of the distributing foreign corporation, increased by the amount of gain (if any) recognized by the distributing foreign corporation on the distribution of the property. However, the basis of the distributed property in the hands of the distributee foreign corporation shall not exceed the fair market value of such property where the distributing foreign corporation recognizes gain on the distribution under this section and the distributee foreign corporation recognizes gain under section 897(e) or the regulations thereunder. See §1.897-5T(b)(3)-(iv)(B).

(ii) *Distribution under section 367(b).* With respect to the treatment of certain distributee foreign corporations under section 367(b), see §7.367(b)-5(c).

(iii) *Distribution or exchange of U.S. real property interests.* With respect to the treatment under section 897(d) of a distributing foreign corporation on the distribution of a U.S. real property interest, see §1.897-5T-(c)(2)(i) and (ii). With respect to the treatment under section 897(e) of the distributee foreign corporation where the distributing foreign corporation has made an election under section 897(i) and the stock of such corporation is treated as a U.S. real property interest, see §1.897-5T(b)(3)(iv)(B).

(iv) *Distribution of stock of a passive foreign investment company.* [RESERVED]

(v) *Carryover of tax attributes.* In regard to the carryover of certain tax attributes from the distributing foreign corporation to the distributee foreign corporation, see section 381 and the regulations thereunder.

(4) *Examples.* The rules of this paragraph (c) may be illustrated by the follow examples.

Example (1). (i) FX1, a Country Y corporation, owns all of the outstanding stock of FX2, a Country Y corporation that is not a passive foreign investment company. FX2 owns Parcel P (a U.S. real property interest), Asset #1 that formerly was used by FX2 in its U.S. trade or business, and Asset # 2 currently used by FX2 in its U.S. trade or business. Asset #1 ceased to be used in a U.S. trade or business on September 31, 1987. All of the property has appreciated in value since acquired by FX2.

(ii) In a liquidation under section 332, FX2 distributes all of its property to FX1 on December 31, 1989. FX1 uses Asset #2 in the conduct of a trade or business in the United States immediately after the distribution.

(iii) Under paragraphs (c)(1) and (2) of this section, FX2 does not recognize gain under section 367(e)(2) on the distribution of Parcel P. Any gain realized on Parcel P may be subject to taxation under section 897 (d) if certain procedural requirements contained in §1.897-5T(d)(1)(iii) are not followed. FX2 must recognize gain on the distribution of Asset #1 under paragraph (c)(2)(ii) of this section. Section 864(c)(7) shall govern the treatment of the gain recognized by FX2 on Asset #1 as income effectively connected with a trade or business in the United States. Because FX2 used and FX1 uses Asset #2 in the conduct of a trade or business in the United States, FX2 will not recognize gain under paragraph (c)(2)(i) of this section on the distribution of Asset #2 if FX1 and FX2 comply with the requirements of that paragraph.

(iv) Under paragraph (c)(3)(i) of this section, FX1 takes FX2's basis in Parcel P and Asset #2 if there is compliance with the requirements. Under paragraph (c)(3)(i) of this section, FX1 takes FX2's basis in Asset #1 increased by the gain recognized.

Example (2). (i) FY1, a Country F corporation, owns all of the outstanding stock of FY2, a Country F corporation that is not a passive foreign investment company. FY2 owns Parcel P (a U.S. real property interest held for investment) and machinery used in its U.S. trade or business. FY2 has made an effective election under section 897(i), and the FY2 stock is treated as a U.S. real property interest.

(ii) In a liquidation under section 332, FY2 distributes all of its property to FY1. FY1 will use the machinery in the conduct of a trade or business in the United States immediately after the distribution.

(iii) Under paragraphs (c)(1) and (2) of this section, FY2 does not recognize gain under section 367(e)(2) on the distribution of Parcel P. Any gain realized on Parcel P may be subject to taxation under section 897(d) if certain procedural requirements contained in §1.897-5T(d)(1)(iii) are not followed. Because FY2 used and FY1 continues to use the machinery in the conduct of a trade or business in the United States, FY2 does not recognize gain on the distribution of the machinery under paragraph (c)(2)(i) of this section if FY1 and FY2 comply with the requirements of that paragraph.

(iv) Under paragraph (c)(3)(i) of this section, FY1 takes FY2's basis in Parcel P. Under paragraph (c)(3)(i) of this section, FY1 takes FY2's basis in the machinery. See §1.897-5T(b)(3)(iv)(B) for the treatment of FY1 under section 897(e).

(d) *Effective date.* This section shall be effective for distributions after July 31, 1986, pursuant to section 337(a) as in effect after the effective dates of the amendments of section 631 of the Tax Reform Act of 1986, except that it shall not apply in the case of any corporation completely liquidated before June 10, 1987, into a corporation organized in a country which then had an income tax treaty with the United States. See section 1006(e)(13) of the Technical and Miscellaneous Revenue Act of 1988 (102 Stat. 3342, Pub. L. 100-647).

Par. 4. Section 1.381(b)-1(a)(1) is revised to read as follows.

§1.381(b)-1 Operating rules applicable to carryovers in certain corporate acquisitions.

(a) *Closing of taxable year*—(1) *In general.* Except in the case of certain reorganizations qualifying under section 368(a)(1)(F), the taxable year of the distributor or transferor corporation shall end with the close of the date of distribution or transfer. With regard to the closing of the taxable year of the transferor corporation in certain reorganizations under section 368(a)(1)(F) involving a foreign corporation after December 31, 1986, see §§1.367(a)-1T(e) and 7.367(b)-1(e).

TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX REFORM ACT of 1976

Par. 5. The authority for Part 7 continues to read as follows: Authority: 26 U.S.C. 7805.

Par. 6. Section 7.367(b)-1 is amended by adding the following paragraphs as new paragraphs (e) and (f).

§7.367(b)-1 Other transfers.

* * * * *

(e) *Close of taxable year in certain section 368(a)(1)(F) reorganizations.* If a foreign corporation is the transferor corporation in a reorganization described in section 368(a)(1)(F) after March 30, 1987, in which the acquiring corporation is a domestic corporation, then the taxable year of the transferor corporation shall end with the close of the date of the transfer and the taxable year of the acquiring corporation shall end with the close of the date on which the transferor's taxable year would have ended but for the occurrence of the transfer. If a foreign corporation, with effectively connected earnings and profits or non- previously taxed accumulated effectively connected earnings and profits (as defined in the regulations under section 884), is the transferor corporation in a reorganization described in section 368(a)(1)(F) in a taxable year beginning after February 15, 1990 (or in a taxable year beginning after December 31, 1986, and on or before February 15, 1990, to which

the transferor corporation chooses to apply this rule), in which the acquiring corporation is a foreign corporation, then the taxable year of the transferor corporation shall end with the close of the date of the transfer and the taxable year of the acquiring corporation shall end with the close of the date on which the transferor's taxable year would have ended but for the occurrence of the transfer. With regard to the consequences of the closing of the taxable year, see section 381 and the regulations thereunder.

(f) *Exchanges under sections 354(a) and 361(a) in certain section 368(a)(1)(F) reorganizations.* In every reorganization under section 368(a)(1)(F), where the transferor corporation is a foreign corporation, there is considered to exist—

(1) A transfer of assets by the transferor corporation to the acquiring corporation under section 361(a) in exchange for stock of the acquiring corporation and the assumption by the acquiring corporation of the transferor corporation's liabilities;

(2) A distribution of the stock (or stock and securities) of the acquiring corporation by the transferor corporation to the shareholders (or shareholders and security holders) of the transferor corporation; and

(3) An exchange by the transferor corporation's shareholders (or shareholders and security holders) of the stock (or stock and securities) of the transferor corporation for stock (or stock and securities) of the acquiring corporation under section 354(a).

For this purpose, it shall be immaterial that the applicable foreign or domestic law treats the acquiring corporation as a continuance of the transferor corporation.

OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 7. The authority citation for Part 602 continues to read as follows: Authority: 26 U.S.C. 7805.

Par. 8. Section 602.101(c) is amended by inserting in the appropriate place in the table "§1.367(e)-1T . . . 1545-1124". "§1.367(e)-2T . . . 1545-1124".

Michael J. Murphy,
Acting Commissioner of Internal Revenue.

Approved December 4, 1989.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 12, 1990, 8:45 a.m., and published in the issue of the Federal Register on January 16, 1990, 55 F.R. 1406)

Part V.—Carryovers

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted federal long-term rate is set forth for the month of January 1990. See Rev. Rul. 90-1, page 155.

The adjusted federal long-term rate is set forth for the month of February 1990. See Rev. Rul. 90-12, page 156.

The adjusted federal long-term rate is set forth for the month of March 1990. See Rev. Rul. 90-22, page 158.

The adjusted federal long-term rate is set forth for the month of April 1990. See Rev. Rul. 90-28, page 159.

The adjusted federal long-term rate is set forth for the month of May 1990. See Rev. Rul. 90-41, page 161.

The adjusted federal long-term rate is set forth for the month of June 1990. See Rev. Rul. 90-48, page 162.

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26 CFR 1.382-2T: Definition of ownership change under section 382, as amended by the Tax Reform Act of 1986 (temporary).

Segregation of options under section 1.382-2T. The segregation rules of section 1.382-2T(j)(2) of the temporary regulations do not apply to create separate direct public groups of shareholders with respect to options issued before September 4, 1987.

Rev. Rul. 90-15

ISSUE

Whether a loss corporation has an ownership change on the issuance of warrants pursuant to the transitional rules of section 1.382-2T(m)(4) of the temporary Income Tax Regulations.

FACTS

Situation 1

L is a loss corporation for purposes of section 382 of the Internal Revenue Code. *L* had one million shares of common stock outstanding, its only class of stock. On January 1, 1987, *L* issued 818,000 shares of common stock to an individual investor, *A*. Except for investor *A*, no person has owned directly 5 percent or more of *L* common stock since May 5, 1986. On January 2, 1987, *L* issued warrants to acquire 400,000 shares of its common stock in a public offering. Investor *A* has never owned any of the warrants. The warrants have not lapsed and have not been exercised. At no time since the warrants were issued would acquisition of the *L* common stock subject to the warrants have caused any warrant holder to own directly 5 percent or more of *L* common stock.

L is required to make a determination whether an ownership change occurred on the date the warrants were issued, January 2, 1987. Section 1.382-2T(a)(2)(i) of the temporary regulations. For reasons unrelated to the warrants, *L* is required to make another such determination on September 4, 1987.

Situation 2

The facts are the same as in *Situation 1*, except the warrants were issued on September 4, 1987, and this is the only date on which *L* is required to make a determination whether an ownership change occurred.

LAW

Section 382 of the Code provides limitations on net operating loss carryovers, net operating losses, and unrealized losses of a "loss corporation" that has an "ownership change." Generally, section 382(g)(1) provides that a loss corporation has an ownership change if the percentage

of stock owned by one or more "5-percent shareholders" of the corporation has increased by more than 50 percentage points over the lowest percentage of stock of the corporation owned by such shareholders at any time during a "testing period." Generally, a testing period is the 3-year period ending on the "testing date." Section 1.382-2T(d)(1) of the temporary regulations; *see* section 382(i). The testing date is the date on which a loss corporation is required to make a determination whether an ownership change has occurred. Section 1.382-2T(a)(2)(i).

Section 382(l)(3)(A)(iv) of the Code provides that, except as provided in regulations, options and similar interests will be treated as exercised if such exercise would cause an ownership change. Section 1.382-2T(h)(4)(i) of the temporary regulations provides that, solely for the purpose of determining whether there is an ownership change on any testing date, stock of a loss corporation that is subject to an option (or a similar interest, including a warrant) is treated as acquired by exercise of the option (warrant) on the testing date, if acquisition of this stock would result in an ownership change ("the option rule").

Section 382(k)(7) of the Code provides that the term "5-percent shareholder" means any person holding 5 percent or more of the stock of the loss corporation at any time during the testing period. However, under section 382(g)(4), persons who each own (directly or indirectly) less than 5 percent of the stock of the loss corporation may be aggregated or segregated into one or more groups that are treated as separate 5-percent shareholders. Sections 1.382-2T(g) and (j) of the temporary regulations provide rules to identify groups of such persons ("public groups") and to determine whether a public group is a 5-percent shareholder. As one example, a public group having a direct ownership interest in the loss corporation that is determined to be a 5-percent shareholder is treated as an individual unrelated to any other shareholder of the loss corporation, section 1.382-2T(j)(1)(ii) and (iii), and is referred to as a "direct public group," section 1.382-2T(j)(2)(ii).

Under section 1.382-2T(j)(2)(iii)(B) of the temporary regulations, if stock of a loss corporation is acquired pursuant to the exercise of a warrant (a transaction to which section 1032 of the Code applies), subject to the taxpayer's overcoming certain presumptions established by regulations, each direct public group that exists immediately after this transaction is segregated so that each direct public group that existed immediately before the transaction is treated separately from the direct public group that acquires stock in the transaction.

Under section 1.382-2T(j)(2)(iii)(D) of the temporary regulations, if stock of a loss corporation is treated as acquired pursuant to a deemed exercise under section 1.382-2T(h)(4)(i) of a warrant issued by the loss corporation, subject to the taxpayer's overcoming certain presumptions established by regulations, each direct public group that exists immediately after this deemed acquisition is segregated so that each direct public group that existed immediately before the transaction is treated separately from the direct public group that is deemed to acquire stock as a result of the issuance of the warrant. The determination of whether the deemed exercise rule of section 1.382-2T(h)(4)(i) applies to a warrant (that is, the determination of whether the acquisition of the stock subject to the warrant would result in an ownership change) is made after applying the segregation rule of section 1.382-2T(j)(2)(iii)(D).

Section 1.382-2T(m)(4) of the temporary regulations provides transitional rules for the application of the segregation rules in section 1.382-2T(j). Under section 1.382-2T(m)(4)(i), section 1.382-2T(j)(2) generally does not apply for purposes of determining whether an ownership change occurs for any testing date occurring before September 4, 1987.

An additional transitional rule is provided with respect to the application of the segregation rules for testing dates occurring on or after September 4, 1987. Section 1.382-2T(m)(4)(iii) of the temporary regulations (emphases added) provides:

> For purposes of determining whether an ownership change occurs for any testing date on or after September 4, 1987, the rules of paragraphs (j)(2) and (3) of this section shall not apply to identify any public group resulting from—
> (A) any *transaction* described in such paragraphs (j)(2) and (3), unless that transaction is also described in paragraphs (m)(4)(i)(B) or (C) of this section, or
> (B) any disposition of stock acquired on or before May 5, 1986, but only if such disposition or other *transaction* occurs before September 4, 1987. Thus, for example, the rules of paragraph (j)(2)(iii)(D) of this section shall apply only to rights to acquire stock of the loss corporation issued on or after such date.

The issuance of warrants by a loss corporation to a direct public group is neither a transaction described in section 1.382-2T(m)(4)(i)(B) or (C) of the temporary regulations (mentioned in subdivision (A) of section 1.382-2T(m)(4)(iii), quoted above), nor a disposition of stock (mentioned in above-quoted subdivision (B)).

ANALYSIS

For section 382 of the Code to apply to a loss corporation, it must have an ownership change on the testing date; that is, one or more 5-percent shareholders of the loss corporation must experience an increase in ownership of loss corporation stock of more than 50 percentage points relative to their respective lowest ownership interests during the testing period. An increase in percentage ownership by a 5-percent shareholder can occur only if there are (or have been) at least two 5-percent shareholders of the loss corporation. Otherwise, the percentage ownership of the loss corporation by its only 5-percent shareholder would never change; it would always be 100 percent.

In *Situations 1* and *2*, immediately before the issuance of the warrants, *L* corporation had two 5-percent shareholders—the direct public group, composed of *L* common shareholders each of whom were less-than-5-percent shareholders, and investor *A*. The acquisition by *A* of the 818,000 shares of common stock on January 1, 1987, increased *A*'s ownership interest in *L* (and decreased the direct public group's ownership interest in *L*) by approximately 45 percentage points (818,000 / (1,000,000 + 818,000)).

Situation 1

The first testing date is January 2, 1987, the date the warrants were is-

sued. The segregation rule of section 1.382-2T(j)(2)(iii)(D) does not apply on this testing date to treat the warrant holders as a separate 5-percent shareholder because the testing date is before September 4, 1987. Section 1.382-2T(m)(4)(i). For purposes of determining whether there is an ownership change on this testing date, *L* common stock subject to the warrants is treated as acquired by the warrant holders at the close of the testing date, and the warrant holders are treated as members of the direct public group, if the deemed acquisition of this *L* common stock by the warrant holders would result in an ownership change. Section 1.382-2T(h)(4)(i) of the temporary regulations. An exercise of the warrants on the testing date would raise the ownership interest of the direct public group of *L* from approximately 55 percentage points to approximately 63 percentage points ((1,000,000 + 400,000) / (1,000,000 + 818,000 + 400,000)). An exercise of the warrants on the testing date would decrease the ownership interest of investor *A* from approximately 45 percentage points to approximately 37 percentage points (818,000 / (1,000,000 + 818,000 + 400,000)). Thus, during the testing period, the increases in the ownership of *L* common stock are approximately 8 percentage points for the direct public group and 37 percentage points for investor *A*, for a total of only 45 percentage points. Accordingly, the warrants would not be deemed exercised under section 1.382-2T of the temporary regulations because the deemed exercise would not result in an ownership change of *L*.

Similarly, on the second testing date, September 4, 1987, there can be no ownership change resulting from issuance of the warrants unless the segregation rules and the option rules apply. Under section 1.382-2T(m)(4)(iii)(A) of the temporary regulations, the transitional rule for testing dates on or after September 4, 1987, the segregation rules of section 1.382-2T(j)(2) generally do not apply to identify a public group resulting from a "transaction" occurring before such date. As one example of a "transaction," the transitional rule states that section 1.382-2T(j)(2)(iii)(D) applies only to rights to acquire stock issued on or after September 4, 1987. Because the "transaction," that is, *L*'s issuance of the warrants, occurred before September 4, 1987, section 1.382-2T(j)(2)(iii)(D) does not apply to segregate the warrant holders on the second testing date. As a result, the option rules do not apply because no shift in the ownership of the loss corporation results from the hypothetical exercise of the warrants in the absence of the application of the segregation rules. Accordingly, issuance of the warrants does not result in an ownership change on the second testing date.

An actual exercise of the warrants on or after September 4, 1987, would raise the issue of whether a new transaction has occurred for purposes of section 1.382-2T(m)(4)(iii)(A). However, solely for the purpose of interpreting this transitional rule, the exercise of a warrant issued before September 4, 1987, relates back to the issue date of the warrant. Therefore, in *Situation 1*, regardless of when the warrants actually are exercised, the segregation rules of section 1.382-2T(j)(2)(iii)B) of the temporary regulations do not apply to the actual exercise. For the same reason that the deemed exercise of the warrants would not cause an ownership change, the actual exercise of the warrants would not cause an ownership change.

Situation 2

The only testing date is September 4, 1987, the date the warrants were issued. Because the issue date is on or after September 4, 1987, the transitional rules of section 1.382-2T(m)(4) of the temporary regulations do not apply. Hence, the segregation rules of section 1.382-2T(j)(2)(iii)(D) apply to treat the warrant holders as a direct public group separate from the direct public group of *L* common shareholders existing immediately before the issuance.

For purposes of determining whether there is an ownership change on this testing date, *L* common stock subject to the warrants is treated as acquired by the warrant holders at the close of the testing date if the deemed acquisition of this *L* common stock by the warrant holders would result in an ownership change. Section 1.382-2T(h)(4)(i) of the temporary regulations. Acquisition of this *L* common stock by the warrant holders would result in an increase in their ownership interest from zero to approximately 18 percentage points (400,000 / 1,000,000 + 818,000 + 400,000). An exercise of the warrants on the testing date would decrease the ownership interest of investor *A* from approximately 45 percentage points to approximately 37 percentage points (818,000 / (1,000,000 + 818,000 + 400,000)). Such an exercise would result in increases in ownership of *L* common stock during the testing period of approximately 18 percentage points for the separate direct public group made up of warrant holders and 37 percentage points for investor *A*, for a total of 55 percentage points. Accordingly, the warrants would be deemed exercised under section 1.382-2T of the temporary regulations because the deemed exercise would result in an ownership change of *L*.

HOLDING

Under the transitional rules of section 1.382-2T(m)(4) of the temporary regulations, the segregation rules of section 1.382-2T(j)(2)(iii)(B) and (D) (concerning, respectively, the actual and deemed exercise of rights to acquire stock) do not apply to treat the warrant holders as a 5-percent shareholder separate from the direct public group of *L* common shareholders, unless the warrants were issued on or after September 4, 1987.

In *Situation 1*, the segregation rules do not apply because the warrants were issued on January 1, 1987, and a deemed exercise of the warrants does not result in an ownership change on either testing date.

In *Situation 2*, the segregation rule of section 1.382-2T(j)(2)(iii)(D) of the temporary regulations applies on the testing date to treat the warrant holders as a 5-percent shareholder separate from the direct public group of *L* common shareholders. Because increases in the percentage ownership of *L* common stock attributable to the purchase by *A* and the deemed exercise of the warrants during the testing period totals more than 50 percentage points, an ownership change of *L* has occurred on this date.

26 CFR 1.382-2T: Definition of ownership change under section 382, as amended by the Tax Reform Act of 1986 (temporary).

T.D. 8277

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Temporary Regulations Under Section 382 of the Internal Revenue Code of 1986; Limitations on Corporate Net Operating Loss Carryforwards

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: Temporary regulations at §§1.382-1T and -2T were published in the Federal Register on August 11, 1987, 52 FR 29663, [T.D. 8149, 1987-2 C.B. 85] to provide guidance regarding what constitutes an "ownership change" under section 382, after which certain corporate attributes, such as net operating loss carryforwards, are limited. This document amends the temporary regulations under section 382 of the Internal Revenue Code (Code) to grant the Service authority to issue revenue rulings (or other guidance in the Internal Revenue Bulletin) to provide additional exceptions under §1.382-2T(h)(4)(x) to the operation of the option attribution rules at §1.382-2T(h)(4)(i) to loss corporations. This amendment of the regulations will give the Treasury Department greater flexibility in providing additional exceptions to the attribution rules of §1.382-2T(h)(4)(i), as circumstances justifying those exceptions are identified.

EFFECTIVE DATE: The temporary regulations are effective as of December 26, 1989.

SUPPLEMENTARY INFORMATION:

Background

Section 382 was amended by section 621 of the Tax Reform Act of 1986 (Pub. L. 99-514; 100 Stat. 2085) [1986-3 C.B. (Vol. 1) 1, 171]. Temporary regulations at §§1.382-1T and -2T were published in the Federal Register on August 11, 1987, 52 FR 29663, to provide guidance regarding what constitutes an "ownership change" under section 382, after which certain corporate attributes, such as net operating loss carryforwards, are limited. This document provides temporary regulations amending the temporary regulations at paragraph (h)(4)(x) of §1.382-2T to grant the Service the authority to issue revenue rulings (or other guidance in the Internal Revenue Bulletin) to provide additional exceptions to the operation of the option attribution rules of §1.382-2T(h)(4)(i).

Explanation of Provisions

Section 382(g)(1) provides that there is an ownership change if, immediately after any owner shift involving a 5-percent shareholder or any equity structure shift, the percentage of stock of the new loss corporation owned by one or more 5-percent shareholders has increased by more than 50 percentage points over the lowest percentage of stock of the old loss corporation (or any predecessor corporation) owned by such shareholders at any time during the testing period.

Section 318(a)(4) of the Code provides that if any person has an option to acquire stock, such stock shall be considered as owned by such person. Section 382(1)(3)(A)(iv) of the Code generally is to the effect that the attribution rules of section 318(a)(4) will apply (both with respect to options and certain other similar interests) if application of those attribution rules will result in an ownership change. Section 382(1)(3)(A)(iv) provides, however, that regulations may exempt certain interests from those attribution rules.

In keeping with the Code provision, §1.382-2T(h)(4)(i) of the temporary regulations provides that, solely for the purpose of determining whether there is an ownership change on any testing date, stock of the loss corporation that is subject to an option shall be treated as acquired on any such date, pursuant to an exercise of the option by its owner on that date, if such deemed exercise would result in an ownership change. Section 1.382-2T(h)(4)(v) of the temporary regulations provides that an interest that is similar to an option shall be treated as an option and that such an interest includes, but is not limited to, a warrant, a convertible debt instrument, an instrument other than debt that is convertible into stock, a put, a stock interest subject to risk of forfeiture, and a contract to acquire or sell stock. Section 1.382-2T(h)(4)(iii) of the temporary regulations generally provides that the extent to which an option is contingent or otherwise not currently exercisable shall be disregarded.

The option attribution rules are necessary to prevent the avoidance of the section 382 limitation, under which the use of pre-change losses is limited in the event of an ownership change. In the absence of option attribution rules, a section 382 ownership change could be avoided in an acquisition that would otherwise result in an ownership change by a person who, instead of acquiring stock of the loss corporation, acquires an option to acquire such stock. Certain options, however, are unlikely to be used for the purpose of circumventing the section 382 limitation. Section 1.382-2T(h)(4)(x) of the temporary regulations provides for certain exceptions to the attribution rules of §1.382-2T(h)(4)(i) for such options that were identified as of the time those regulations were issued.

Notice 88-67, 1988-1 C.B. 555, states that the Internal Revenue Service intends to amend the temporary regulations under section 382 of the Code to grant the Service the authority to issue revenue rulings providing additional exceptions under §1.382-2T(h)(4)(x). Accordingly, this document adds §1.382-2T(h)(4)(x)(Z) to the temporary regulations, in order to grant the Service the authority to designate in the Internal Revenue Bulletin additional options to be excepted from the option attribution rules of §1.382-2T(h)(4)(i). This amendment of the regulations will give the Treasury Department greater flexibility in providing additional exceptions to the attribution rules of §1.382-2T(h)(4)(i), as circumstances justifying those exceptions are identified. Only options or similar interests that are specifically identified in regulations or in the Internal Revenue Bulletin are excepted from option attribution.

Special Analyses

It has been determined that these regulations are not major regulations as defined in Executive Order 12291.

Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, Title 26, Chapter 1, Part 1 of the Code of Federal Regulations is amended as follows:

PART 1—[AMENDED]

Paragraph 1. The authority for Part 1 continues to read, in part:

Authority: 26 U.S.C. 7805; *** §1.382-2T also issued under 26 U.S.C. 382(g)(4)(C) ***, 26 U.S.C. 382(i) ***, 26 U.S.C. 382(k)(1) ***, 26 U.S.C. 382(k)(6) ***, 26 U.S.C. 382(l)(3) ***, 26 U.S.C. 382(m).

Par. 2. Section 1.382-2T is amended by adding and reserving paragraphs (h)(4)(x)(I)—(Y) and by adding a new paragraph (h)(4)(x)(Z) to read as set forth below:

§1.382-2T Definition of ownership change under section 382, as amended by the Tax Reform Act of 1986 (temporary).

* * * * *

(h) ***

(4) ***

(x) ***

(I)—(Y) [Reserved]

(Z) *Options designated in the Internal Revenue Bulletin.* Any option designated by the Internal Revenue Service in the Internal Revenue Bulletin as being excepted from the operation of §1.382-2T(h)(4)(i).

* * * * *

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved December 4, 1989.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 22, 1989, 8:45 a.m., and published in the issue of the Federal Register for December 26, 1989, 54 F.R. 52935)

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26 CFR 1.382-2T: Definition of ownership change under section 382, as amended by the Tax Reform Act of 1986 (temporary).

A corporation's adoption of a "poison pill" plan does not cause any taxpayer to realize gross income. See Rev. Rul. 90-11, page 10.

Part VI.—Treatment of Certain Corporate Interests as Stock or Indebtedness

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Section 385.—Treatment of Certain Interests in Corporations as Stock or Indebtedness

The terms of the described issue of dutch-auction rate preferred stock do not prevent the corporation receiving a dividend distribution with respect to the stock from claiming the dividend received deduction. See Rev. Rul. 90-27, page 50.

Subchapter D.—Deferred Compensation, etc.

Part I.—Pension, Profit-Sharing, Stock Bonus Plan, etc.

Subpart A.—General Rule

Section 403.—Taxation of Employee Annuities

26 CFR 1.403(b)-1: Taxability of beneficiary under annuity purchased by a section 501(c)(3) organization or public school.

Direct transfers. A direct transfer between section 403(b) of the Code investment vehicles does not constitute an actual distribution under section 403(b)(1). Rev. Rul. 73-124 revoked.

Rev. Rul. 90-24

ISSUE

Does a transfer of all or part of the holder's interest in a section 403(b)(1) annuity contract or a section 403(b)(7) custodial account ("section 403(b) investments") to another section 403(b)(1) annuity contract or section 403(b)(7) custodial account constitute an actual distribution to the holder within the meaning of section 403(b)(1)?

FACTS

Individuals *A* and *B* are employed by Organization M, a tax-exempt entity described in section 501(c)(3) of the Code. Neither *A* nor *B* has reached age 59-1/2. Organization *M* purchased Contract 1, a section 403(b)(1) annuity contract, for *A* and Account 1, a section 403(b)(7) custodial account, for *B*. These purchases were made entirely with nonelective contributions made by Organization *M*.

A directed the transfer of one half of *A*'s interest in Contract 1 to Contract 2, a section 403(b)(1) annuity contract, by requesting the issuer of Contract 1 to transfer an amount representing one half of *A*'s interest in Contract 1 as calculated under the terms of Contract 1 to the issuer of Contract 2.

B directed the transfer of *B*'s interest in Account 1 to Contract 3, a section 403(b)(1) annuity contract, by requesting the custodian of Account 1 to transfer an amount representing *B*'s interest in Account 1 to the issuer of Contract 3. Contract 3 provides that amounts (including any earnings allocable to such amounts) transferred to Contract 3 from any section 403(b) investment that are subject to the early distribution restrictions of section 403(b)(7)(A)(ii) or section 403(b)(11) will be accounted for separately and will continue to be subject to identical early distribution restrictions.

LAW

Section 403(b)(1) of the Code provides that if an annuity contract is purchased for an employee by an employer within certain categories, including an employer described in section 501(c)(3), and if the annuity contract meets certain specified criteria, then amounts contributed by the employer for the annuity contract on or after the employee's rights under the contract become nonforfeitable are excluded from the gross income of the employee for the taxable year within certain limitations. Section 403(b)(1) provides that the amount actually distributed to any distributee under the annuity contract is taxable to the distributee (in the year so distributed) under section 72 (relating to annuities).

Section 403(b)(7) of the Code provides that amounts paid by a qualifying employer to a custodial account that satisfies the requirements of section 401(f)(2) are treated as amounts

contributed by the employer to an annuity contract for an employee, provided that the amounts are to be invested in regulated investment company stock to be held in that custodial account. Section 403(b)(7)(A)(ii) provides that amounts paid by an employer to a custodial account are treated as amounts contributed by the employer to an annuity contract for an employee only if no amounts may be paid or made available to any distributee before the employee dies, attains age 59-1/2, separates from service, becomes disabled, or, in the case of contributions made pursuant to a salary reduction agreement, encounters financial hardship. Similarly, section 403(b)(11) provides that a distribution from a section 403(b) investment attributable to salary reduction contributions may be paid only when the employee attains age 59-1/2, separates from service, dies, or becomes disabled. Distributions attributable to those contributions may also be paid in the case of hardship, but the distributions may not include income attributable to those contributions. Section 403(b)(11) is effective for years beginning after December 31, 1988, but only with respect to distributions attributable to assets other than assets held as of the close of the last year beginning before January 1, 1989.

Section 401(g) of the Code provides that, for purposes of section 403, the term "annuity" does not include any contract or certificate issued after December 31, 1962, that is transferable.

Rev. Rul. 73-124, 1973-1 C.B. 200, holds that, where an employee received a complete distribution from one section 403(b) annuity contract and immediately surrendered the proceeds to the employer who purchased a new section 403(b) annuity contract from a different insurer pursuant to a preexisting binding agreement, the transaction was a nontaxable exchange under section 1035(a)(3) of the Code. The revenue ruling states that the employee was required to surrender the original annuity contract because of the restrictions imposed by section 401(g).

ANALYSIS

There is no actual distribution within the meaning of section 403(b)(1) of the Code where funds are transferred from one section 403(b) investment to another section 403(b) investment if the transferred funds continue after the transfer to be subject to any distribution restrictions imposed on them prior to the transfer by section 403(b)(11) or section 403(b)(7)(A)(ii). *A* has transferred one half of *A*'s interest in a section 403(b)(1) annuity contract that does not contain funds subject to early distribution restrictions (because the section 403(b)(1) annuity contract was purchased entirely with nonelective contributions made by Organization *M*) to another section 403(b)(1) annuity contract. Because *A* has merely transferred an interest in one section 403(b)(1) annuity contract to another section 403(b)(1) annuity contract where the first contract is not subject to early distribution restrictions, *A* has not received an actual distribution within the meaning of section 403(b)(1) of the Code, and the transfer is not taxable. Because *A* retains *A*'s annuity interest throughout this transaction, the direct transfer between section 403(b) investments is a mere change in issuers that does not violate the nontransferability requirement of section 401(g). *Cf.* section 1.401-9(b)(3) of the Income Tax Regulations. Thus, the underlying premise in Rev. Rul. 73-124 that section 401(g) precludes such transfers is incorrect.

Section 403(b)(7) of the Code provides that amounts paid by a qualifying employer to a section 403(b)(7) custodial account are treated as amounts contributed to an annuity contract under section 403(b)(1). Therefore, a section 403(b)(7) custodial account is treated as equivalent to a section 403(b)(1) annuity contract in determining whether transfers among section 403(b)(1) annuity contracts and section 403(b)(7) custodial accounts are actual distributions within the meaning of section 403(b)(1) of the Code. However, a section 403(b) investment that is subject to early distribution restrictions may not, consistent with these restrictions, permit a transfer to a section 403(b) investment that contains less stringent distribution restrictions.

B has transferred *B*'s interest in Account 1, a section 403(b)(7) custodial account containing the early distribution restrictions of section 403(b)(7)(A)(ii), to Contract 3, a section 403(b)(1) annuity contract that provides that the amounts transferred to Contract 3 from section 403(b) investments, and earnings allocable to those amounts, that are subject to the early distribution restrictions of section 403(b)(7)(A)(ii) or section 403(b)(11) will continue to be subject to identical early distribution restrictions. This transfer is a transfer from one section 403(b) investment to a section 403(b) investment that is subject to identical distribution restrictions. Therefore, the transfer is not an actual distribution within the meaning of section 403(b)(1), and is not taxable.

Similarly, if *B* had instead transferred *B*'s interest in a section 403(b)(1) annuity contract that contained funds subject to the early distribution restrictions of section 403(b)(11) to another section 403(b)(1) contract, the transfer would not be an actual distribution within the meaning of section 403(b)(1) and would not be taxable if the transferred funds were subject to the same or more stringent restrictions.

The above results are not dependent on *A*'s or *B*'s continued employment with Organization *M* and the results would be the same if *A* or *B* were former employees of Organization *M* or beneficiaries of former employees of Organization *M*.

If *A*'s or *B*'s interests in Contract 1 or Account 1, respectively, had been purchased partially with after-tax employee contributions, a pro rata portion of their investments would be considered transferred to either Contract 2 or Contract 3, respectively. For example, if *A* transferred one half of *A*'s interest in Contract 1 to Contract 2, and if the total amount that would have been transferred in a transfer of *A*'s complete interest in Contract 1 was 10x, 4x of which was after-tax employee contributions, then *A*'s investment in Contract 2 would be 2x.

HOLDING

If an individual transfers an interest in a section 403(b)(1) annuity contract not subject to early distribution restrictions to another section 403(b)(1) annuity contract, or to a section 403(b)(7) custodial account, the transfer is not an actual distribution within the meaning of section

403(b)(1) of the Code, and consequently is not a taxable transfer. If an individual transfers funds from a section 403(b)(7) custodial account to a section 403(b)(1) annuity contract, or to another section 403(b)(7) custodial account, and the transferred funds continue to be subject to the early distribution restrictions set forth in section 403(b)(7)(A)(ii), the transfer is not an actual distribution under section 403(b)(1) and consequently is not a taxable transfer. If an individual transfers funds from a section 403(b)(1) annuity contract containing funds subject to the early distribution restrictions of section 403(b)(11) to another 403(b)(1) annuity contract, or to a section 403(b)(7) custodial account, and the transferred funds continue to be subject to the same or more stringent distribution restrictions, the transfer is not an actual distribution under section 403(b)(1) and consequently is not a taxable transfer.

In determining whether any of the above transfers constitutes an actual distribution, it is irrelevant whether a complete interest or a partial interest is transferred, and whether the transferring individual is a current employee, a former employee or a beneficiary of a former employee.

This revenue ruling does not address the consequences of a transfer that violates the early distribution restrictions of section 403(b)(7)(A)(ii) or section 403(b)(11).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 73-124 is revoked.

PROSPECTIVE APPLICATION

Pursuant to the authority contained in section 7805(b) of the Code, the revocation of Rev. Rul. 73-124 will not be effective for any transaction described in Rev. Rul. 73-124 executed on or before December 31, 1991.

Subpart B.—Special Rules

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1990. See Rev. Rul. 90-1, page 155.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1990. See Rev. Rul. 90-12, page 156.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1990. See Rev. Rul. 90-22, page 158.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April. See Rev. Rul. 90-28, page 159.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1990. See Rev. Rul. 90-41, page 161.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 1990. See Rev. Rul. 90-48, page 162.

Section 414.—Definitions and Special Rules

26 CFR 1.414(s)-1T: Definition of compensation (temporary).

T.D. 8301

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Definition of Compensation

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the scope and meaning of the term "compensation" in section 414(s) of the Internal Revenue Code of 1986. They reflect changes made by the Tax Reform Act of 1986 (TRA '86) and conform the existing regulations to section 1115 of the Tax Reform Act of 1986 (100 Stat. 2453) [Pub. L. 99-514, 1986-3 C.B. (Vol. 1) 1, 369] and section 1011(j)(1) of the Technical and Miscellaneous Revenue Act of 1988 [Pub. L. 100-647, 1988-3 C.B. 1, 128]. These temporary regulations provide guidance necessary to comply with the law and will affect sponsors of, and participants in, pension, profit-sharing and stock bonus plans and certain other employee benefit plans. The text of the temporary regulations set forth in this document also serves as the text of the proposed regulations for the notice of proposed rulemaking that appears in * * * [EE-129-86, page 560, this Bulletin]. These temporary regulations are issued in conjunction with three other sets of proposed regulations concerning the application of section 401(a)(4), 401(a)(17), and 401(a)(26) to pension, profit sharing and stock bonus plans. In each of these areas compensation under section 414(s) is an important concept.

EFFECTIVE DATE: These temporary regulations are effective for years beginning on or after January 1, 1987.

SUPPLEMENTARY INFORMATION:

Background

This document amends the Income Tax Regulations (26 CFR Part 1) under section 414(s) and under section 415(c)(3) of the Internal Revenue Code of 1986 (Code). These amendments conform the regulations to section 1115 of the Tax Reform Act of 1986 (TRA '86) and section 1011(j)(1) of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA).

Reissuance of proposed and temporary regulations

Section 1.414(s)-1T, *Compensation*, was originally published, with §1.414(q)-1T, *Highly Compensated Employee*, in the Federal Register on February 19, 1988, as temporary regulations as well as the text of proposed regulations (prior regulations to amend the Income Tax Regulations to conform to section 1115 of the Tax Reform Act of 1986. See 53 FR 4964, 4999. Comments were solicited and a hearing was held on December 1, 1989. The definition of compensation in section 414(s)(1) was substantially revised by section 1011(j)(1) of TAMRA. Consequently §1.414(s)-1T published on February 19, 1988, has been revised and is now reissued as temporary regulations and the text of proposed regulations in order to

corporate the new definition of compensation under section 414(s)(1).

The revised rules have been developed in conjunction with the development of regulations under section 401(a)(4) in order to provide comprehensive guidance on the nondiscrimination requirements applicable to qualified plans. These temporary regulations alter the overall approach taken in the prior temporary regulations. As a result, the provisions in §1.414(s)-1T addressing statutory provisions that remained essentially unchanged have also been substantially revised.

Overview

Section 414(s) and these temporary regulations provide rules for defining compensation for purposes of applying any provision that specifically refers to section 414(s). For example, section 414(s) is explicitly referred to in many of the nondiscrimination provisions applicable to pension, profit-sharing, and stock bonus plans qualified under section 401(a). The amount of plan benefits or contributions, expressed as a percentage of compensation within the meaning of section 414(s), is generally one of the key factors in determining whether these nondiscrimination provisions are satisfied.

These temporary regulations implement the section 414(s) definition of compensation as compensation within the meaning of section 415(c)(3). In addition, these temporary regulations exercise the authority granted to the Secretary in section 414(s) to prescribe alternative nondiscriminatory definitions of compensation.

These temporary regulations also amend the regulations defining compensation within the meaning of section 415(c)(3) to clarify those amounts that are included in compensation under the existing rules and to add the two types of wages reported on Form W-2 to the definitions that automatically satisfy section 415(c)(3).

The revised temporary regulations under section 414(s) provide that any definition of compensation automatically satisfies section 414(s) if it includes all compensation within the meaning of section 415(c)(3) and excludes all other compensation. The temporary regulations also provide a safe harbor alternative definition of compensation that automatically satisfies section 414(s) without further testing. Furthermore, the temporary regulations generally provide that any other reasonable definition of compensation satisfies section 414(s) if the definition does not by design favor highly compensated employees and satisfies a nondiscrimination requirement. Finally, the temporary regulations provide rules that permit compensation to include elective salary reduction contributions specified in section 414(s)(2), section 457 deferred compensation, and section 414(h) employer pick-up amounts.

Definitions of total compensation under section 415(c)(3)

The Code treats compensation within the meaning of section 415(c)(3) as the basic definition of compensation to be used to determine whether plan qualification requirements are satisfied. This definition may therefore be used to apply the limits on benefits and contributions under section 415, to determine which employees of an employer are highly compensated, and to determine whether a plan satisfies any applicable nondiscrimination requirements.

The temporary regulations amend §1.415-2(d) to add the types of wages reported on Form W-2 (FICA wages and wages for purposes of income tax withholding) to the definitions of compensation that satisfy section 415(c)(3). This approach permits use of these W-2 wage amounts for each of the three purposes described above and permits an employer to use compensation data already maintained for employment tax purposes in administering its retirement plan.

Additionally, because the definition of compensation in section 415(c)(3) is the basic definition of compensation used to determine whether plan qualification requirements are satisfied, §1.415-2(d)(1) has been revised to clarify what amounts are included in compensation (within the meaning of section 415(c)(3)) under the existing rules. These revisions are designed to clarify the existing rules with respect to certain items of compensation and make the existing rules easier to use for employers who do not choose to use one of the two new employment tax definitions of compensation.

For purposes of determining both whether a plan is nondiscriminatory and which employees are highly compensated employees, compensation that is currently includable in gross income should be used. Therefore, the temporary regulations eliminate the rule in §1.415-2(d)(4) permitting an employer to elect to use accrued compensation. The temporary regulations provide a de minimis rule that permits an employer to include in compensation amounts earned but not paid in a year because of the timing of pay periods and pay days, as long as these amounts are paid during the first few weeks of the next year. Use of accrued compensation under this de minimis rule is permitted if used on a uniform and consistent basis with respect to all similarly situated employees. The temporary regulations provide a transitional period in order to allow employers to make adjustments for this change. Consequently, the elimination of the election to use accrued compensation applies only to years beginning after December 31, 1991.

Finally, §1.415-2(d) has been updated to reflect certain statutory changes to other sections of the Code. This revision, however, is not comprehensive. For example, no revisions were considered to the rules in §1.415-2(d)(2) for determining amounts not included in compensation. The Service welcomes comments concerning any rules in §1.415-2(d) that require additional clarification or updating.

Alternative definitions of compensation

The alternative definitions of compensation provided in the prior regulations are changed and significantly expanded in these temporary regulations to make the applicable rules easier for employers to use. A safe harbor alternative definition is provided that is deemed to be nondiscriminatory and thus automatically satisfies section 414(s). The method for determining whether other alternative definitions of compensation are discriminatory has been modified.

Under the safe harbor alternative definition, an employer may generally define compensation as including regular or base salary or wages, plus commissions, tips, overtime and other

premium pay, and bonuses, and excluding (even if includable in gross income) reimbursements or other expense allowances, fringe benefits (whether cash or noncash), moving expenses, deferred compensation, and welfare benefits. Consequently, under this alternative definition of compensation, most forms of noncash compensation, which may be difficult to anticipate, are excluded from compensation. Similarly, many forms of compensation that are based on an employee's individual need rather than a rate of payment for services performed are excluded from compensation.

In addition to the safe harbor definition, the temporary regulations provide that any other alternative definition of compensation satisfies section 414(s) if it is reasonable, does not by design favor highly compensated employees, and satisfies a nondiscrimination requirement. Thus, if the definition of compensation under an employer's retirement plan for determining benefits or contributions is reasonable and nondiscriminatory, the employer generally may use that definition to determine if the plan satisfies any applicable nondiscrimination requirements, thereby limiting the compensation data that must be collected to administer the plan.

This flexible approach to defining compensation is intended to accommodate the legitimate business needs and problems of employers while retaining the basic statutory requirement that the definition of compensation must be nondiscriminatory. For example, this approach permits employers to use definitions designed to: (1) exclude amounts that may fluctuate significantly from year to year and thus are difficult for the employer to anticipate; or (2) take into account the relative administrative difficulty of capturing certain amounts on the employer's pension accounting systems. The temporary regulations provide the following examples of compensation that, subject to the applicable facts and circumstances, an employer might exclude under a reasonable definition of compensation: any type of additional compensation for employees working outside their regularly scheduled tour of duty (such as overtime pay, premiums for shift differential, and call-in premiums); bonuses for individual performance; or any type of compensation excluded under the safe harbor definition.

Nondiscrimination requirement

The temporary regulations provide that an alternative definition of compensation is nondiscriminatory under section 414(s) if the average percentage of total compensation included under the alternative definition of compensation for an employer's highly compensated employees as a group does not exceed by more than a de minimis amount the average percentage of total compensation included under the alternative definition for the employer's other employees as a group.

An employer may use any reasonable method to determine whether this requirement is satisfied. For example, an employer may calculate individual percentages for each employee in a group and then average the percentages as described in Q&A-4 of the prior regulations. Alternatively, an employer may calculate an aggregate compensation percentage for each group of employees by dividing the aggregate amount of compensation of all employees in that group that is included under the alternative definition by the aggregate amount of total compensation of all employees in that group. This alternative method is considered reasonable only if it does not produce distortion as a result of the extra weight given employees with higher compensation in the relevant group.

The temporary regulations provide that the determination of whether the average percentage of total compensation included for the employer's highly compensated employees as a group exceeds by more than a de minimis amount the average percentage of total compensation included for the employer's other employees as a group is based on the applicable facts and circumstances.

Consistent with this approach, the temporary regulations provide that the differences between the percentages for prior periods may be considered in determining whether the difference between the percentages for a given period is de minimis, recognizing that small fluctuations in the compensation percentages may be caused by fluctuations in an employer's work force or business operations unrelated to the employer's pension plan. In addition, an isolated instance of a more than de minimis difference between the compensation percentages that is due to an extraordinary unforeseeable event (such as large overtime payments after a major hurricane) will be disregarded if the amount of the difference in prior determination periods was de minimis.

Availability of elective contributions and of employee contributions and matching contributions

These temporary regulations clarify that any reasonable definition of compensation may be used to apply the nondiscrimination requirement with respect to the availability of elective contributions to eligible employees under a cash or deferred arrangement and with respect to the availability of employee contributions and matching contributions under a defined contribution plan. For example, for this limited purpose, it would generally be reasonable to define compensation as including only regular or base salary or wages even if the average percentage of total compensation included for an employer's highly compensated employees under this definition exceeds by more than a de minimis amount the average percentage of total compensation included for an employer's other employees. This special rule is appropriate for testing the availability of elective contributions and of employee contributions and matching contributions because the actual deferral percentage (ADP) test in section 401(k)(3) and the actual contribution percentage (ACP) test in section 401(m) are the principal means for determining whether elective contributions under a cash or deferred arrangement and matching contributions and employee contributions under a defined contribution plan are nondiscriminatory in amount. For the same reason, sections 401(k) and 401(m) require a definition of compensation that satisfies section 414(s) to be used to determine if the ADP test and ACP test are satisfied. Thus, the broad definition of compensation usable for availability testing cannot be used for ADP and ACP testing unless that definition satisfies either the safe harbor or nondiscriminatory alternative definition requirements of section 414(s).

Inclusion of certain elective contributions and deferred compensation

Section 414(s)(2) permits an employer to include in compensation elective contributions that are not includable in gross income under section 125, 402(a)(8), 402(h), or 403(b). The temporary regulations incorporate this alternative and also permit the inclusion in compensation of section 457 deferred compensation (under certain plans maintained by state and local governments or tax-exempt organizations) and employer pick-up amounts (relating to certain government plans).

In the case of the safe harbor definitions of compensation that automatically satisfy section 414(s), the temporary regulations require the definition of compensation to either include or exclude all of the above types of elective contributions and deferred compensation in order to continue automatically to satisfy section 414(s). In order to accommodate the existing practices of employers, however, the temporary regulations permit an alternative definition of compensation under section 414(s) to include some but not all of the types of elective contributions and deferred compensation described above if the definition satisfies the nondiscrimination requirement under section 414(s) taking the elective contributions or deferred compensation into account.

Consistency requirements for use of a definition

The temporary regulations provide that an employer may use any definition of compensation that satisfies section 414(s) to determine if an applicable provision is satisfied with respect to a plan. This rule is designed to permit an employer, whenever possible, to use the definition used under the plan for calculating contributions or benefits to determine if an applicable nondiscrimination provision is satisfied. Consequently, an employer that maintains several pension, profitsharing, or stock bonus plans may generally use one definition of compensation that satisfies section 414(s) in determining whether one of the plans satisfies a particular nondiscrimination requirement (such as section 401(a)(4)) and use the same or a different definition of compensation in determining whether another plan satisfies the same nondiscrimination requirement. The definition of compensation selected generally must be used consistently to define the compensation of all employees taken into account in determining whether a plan satisfies the nondiscrimination provision for the determination period with respect to that provision. This general flexibility in section 414(s) does not overrule any more specific requirements that relate to a particular use of the term compensation.

Effective date of these temporary regulations

These revised temporary regulations are effective for years beginning on or after January 1, 1987. However, for years beginning before May 14, 1990, compliance with either the provisions of these revised temporary regulations or the provisions of the prior regulations constitutes compliance with these revised temporary regulations.

Special analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these temporary regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations is being submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of amendments to the regulations

Accordingly 26 CFR Part 1 is amended as follows:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. The authority citation for Part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * * section 1.414(s)-1T is also issued under 26 U.S.C. 414(s).

Par. 2. Section 1.414(s)-1T is revised to read as follows:

§1.414(s)-1T Definition of compensation (temporary).

(a) *Introduction*—(1) *In general.* Section 414(s) and this section provide rules for defining compensation for purposes of applying any provision that specifically refers to section 414(s) or this section. For example, section 414(s) is explicitly referred to in many of the nondiscrimination provisions applicable to pension, profit-sharing, and stock bonus plans qualified under section 401(a). This section implements the section 414(s) definition of compensation as compensation within the meaning of section 415(c)(3), and it exercises the authority granted to the Secretary to prescribe alternative nondiscriminatory definitions of compensation. A definition of compensation that satisfies section 414(s) may also include certain types of elective contributions and deferred compensation.

(2) *Limitations on scope of section 414(s).* Section 414(s) and this section do not apply unless a provision specifically refers to section 414(s) or these regulations. For example, even though a definition of compensation permitted under section 414(s) must be used in determining whether the contributions or benefits under a pension, profit-sharing, or stock bonus plan satisfy a certain applicable provision (such as section 401(a)(4)), the plan is not required to use a definition of compensation that satisfies section 414(s) in calculating the amount of contributions or benefits actually provided under the plan.

(3) *Overview.* Paragraph (b) of this section provides consistency rules for the use of a definition of compensation that satisfies section 414(s). Paragraph (c) of this section contains specific definitions of compensation that satisfy section 414(s) without satisfying any additional nondiscrimination requirement under section 414(s). Paragraph (d) of this section provides rules permitting the use of alternative definitions of compensation that satisfy section 414(s) as long as the nondiscrimination test described in paragraph (d)(2) of this section is met. Paragraph (e) of this section

provides other special rules, including a special rule for determining the compensation of a self-employed individual under an alternative definition of compensation.

(b) *Consistency requirements for use of a definition.* Any definition of compensation that satisfies section 414(s) may be used when a provision explicitly refers to section 414(s) unless the reference specifically indicates otherwise. For example, any definition of compensation that satisfies section 414(s) may be used to determine whether a particular money purchase pension plan satisfies section 401(a)(4). At the same time, a different definition of compensation that satisfies section 414(s) may be used to determine whether a defined benefit plan maintained by the same employer and not aggregated with the money purchase plan satisfies the requirements of section 401(a)(4). Each definition of compensation selected must be used consistently to define the compensation of all employees taken into account in satisfying the requirements of an applicable provision for the relevant determination period. For example, the same definition of compensation generally must be used consistently to define the compensation of all employees taken into account in determining whether section 401(a)(4) is satisfied in a particular instance. An employer may, however, change its definition of compensation for a subsequent determination period with respect to that same provision. Rules provided under any provision specifically requiring use of a section 414(s) definition of compensation may modify the consistency requirements of this paragraph.

(c) *Specific definitions of compensation that satisfy section 414(s)*—(1) *General rules.* The definitions of compensation provided in paragraphs (c)(2) and (c)(3) of this section satisfy section 414(s) and need not satisfy any additional nondiscrimination requirement under section 414(s). Paragraph (c)(2) of this section describes definitions of compensation within the meaning of section 415(c)(3). Paragraph (c)(3) of this section provides a safe harbor alternative definition of compensation that is deemed nondiscriminatory. Paragraph (c)(4) of this section permits any definition provided in paragraph (c)(2) or (c)(3) of this section to include certain types of elective contributions and deferred compensation.

(2) *Compensation within the meaning of section 415(c)(3).* A definition of compensation that includes all compensation within the meaning of section 415(c)(3) and excludes all other compensation satisfies section 414(s). Section 1.415-2(d)(1) and (d)(2) provide rules for determining items of compensation included in and excluded from compensation within the meaning of section 415(c)(3). In addition, §1.415-2(d)(10) and (d)(11) provide safe harbor definitions that are treated as satisfying section 415(c)(3), and these definitions therefore satisfy section 414(s). Additional definitions of compensation that are prescribed by the Commissioner as satisfying section 415(c)(3) under the authority provided in §1.415-2(d)(12) also satisfy section 414(s).

(3) *Safe-harbor alternative definition.* Under the safe-harbor alternative definition in this paragraph (c)(3), compensation is compensation as defined in paragraph (c)(2) of this section, reduced by all of the following items (even if includable in gross income): reimbursements or other expense allowances, fringe benefits (cash and noncash), moving expenses, deferred compensation, and welfare benefits. However, this definition is not permitted to be used to determine the compensation of a self-employed individual even if the consistency requirement in paragraph (b) of this section would otherwise require using this alternative definition. The compensation for any relevant self-employed individuals must be determined pursuant to the rules in paragraph (e)(1) of this section.

(4) *Inclusion of certain deferrals in compensation.* Any definition of compensation provided in paragraph (c)(2) or (c)(3) of this section will satisfy section 414(s) even though it is modified to include all of the following types of elective contributions and all of the following types of deferred compensation:

(i) Elective contributions that are made by the employer on behalf of its employees that are not includable in income under section 125, section 402(a)(8), section 402(h), or section 403(b);

(ii) Compensation deferred under an eligible deferred compensation plan within the meaning of section 457(b) (deferred compensation plans of state and local governments and tax-exempt organizations); and

(iii) Employee contributions (under governmental plans) described in section 414(h)(2) that are picked up by the employing unit and thus are treated as employer contributions.

(d) *Alternative definitions of compensation*—(1) *Any reasonable definition of compensation*—(i) *General rule.* In addition to the definitions provided in paragraph (c) of this section, any definition of compensation satisfies section 414(s) with respect to employees (other than self-employed individuals) if the definition of compensation is reasonable, does not by design favor highly compensated employees, and satisfies the nondiscrimination requirement in paragraph (d)(2) of this section. Subject to the applicable facts and circumstances, a reasonable definition of compensation is permitted to, on a consistent basis, exclude certain types of compensation, including (but not limited to) one or more of the following: any type of additional compensation for employees working outside their regularly scheduled tour of duty (such as overtime pay, premiums for shift differential, and call-in premiums); bonuses for individual performance; or any type of compensation excluded under the safe harbor alternative definition in paragraph (c)(3) of this section. A reasonable definition of compensation is also permitted to include any of the types of elective contributions or deferred compensation described in paragraph (c)(4) of this section.

(ii) *Availability of elective contributions and of employee contributions and matching contributions.* For the limited purposes of applying the nondiscrimination requirements in §1.401(k)-1(e)(1)(ii) with respect to the availability of elective contributions to eligible employees under a cash or deferred arrangement and in §1.401(m)-1(c)(1) with respect to the availability of employee contributions and the availability of matching contributions under a defined contribution plan, any reasonable definition of compensation, such as regular or base salary or wages, is treated as

nondiscriminatory and therefore satisfies section 414(s). This special rule does not apply for any other purpose, including application of the actual deferral percentage test of section 401(k)(3) or the actual contribution percentage test of section 401(m)(2).

(iii) *Self-employed individuals.* An alternative definition of compensation under this paragraph (d) is not permitted to be used to determine the compensation of a self-employed individual even if the consistency requirement in paragraph (b) of this section would otherwise require using this alternative definition. The compensation for any relevant self-employed individuals must be determined pursuant to the rules in paragraph (e)(1) of this section.

(2) *Nondiscrimination requirement*—(i) *In general.* An alternative definition of compensation under this paragraph (d) is nondiscriminatory under section 414(s) if the average percentage of total compensation included under the alternative definition of compensation for an employer's highly compensated employees as a group does not exceed by more than a de minimis amount the average percentage of total compensation included under the alternative definition for the employer's other employees as a group.

(ii) *Total compensation.* For purposes of this paragraph (d)(2), total compensation must be determined using a definition of compensation provided in paragraph (c)(2) of this section. An employer is permitted to increase this amount by including all the types of elective contributions and deferred compensation described in paragraph (c)(4) of this section. Total compensation taken into account for each employee (including, if added, the elective contributions and deferred compensation described in paragraph (c)(4) of this section) may not exceed the annual compensation limit of section 401(a)(17).

(iii) *Employees taken into account.* In applying the requirement of this paragraph (d)(2), the employees taken into account are the same employees taken into account in satisfying the requirements of the applicable provision that refers to section 414(s). Alternatively, all of the nonexcludable employees of the employer may be taken into account in applying the requirements of this paragraph (d)(2), unless doing so can reasonably be expected to result in a distortion in the percentages that is more than de minimis given the compensation characteristics of the employer's work force. For purposes of determining the employees taken into account under either alternative, self-employed individuals are disregarded.

(iv) *Facts and circumstances determination.* The determination of whether the average percentage of total compensation included for the employer's highly compensated employees as a group exceeds by more than a de minimis amount the average percentage of total compensation included for the employer's other employees as a group is based on the applicable facts and circumstances. The differences between the percentages for prior periods may be considered in determining whether the amount of the difference between the percentages for a given period is more than de minimis. In addition, an isolated instance of a more than de minimis difference between the compensation percentages that is due to an extraordinary unforeseeable event (such as overtime payments due to a major hurricane) will be disregarded if the amount of the difference in prior determination periods was de minimis.

(e) *Special rules*—(1) *Self-employed individuals*—(i) *General rule.* If an alternative definition of compensation under paragraph (c)(3) or (d) of this section is used to satisfy an applicable provision, an equivalent alternative compensation amount must be determined for any self-employed individual who is in the group of employees for whom paragraph (b) of this section requires a single definition of compensation to be used. This equivalent alternative compensation amount is determined by multiplying the self-employed individual's total earned income (as defined in section 401(c)(2)) by the percentage of total compensation (as defined in paragraph (d)(2)(ii) of this section) included under the alternative definition for the employer's common-law employees as a group (determined in a manner consistent with the rules in paragraph (d)(2)(iii) of this section). For purposes of this determination, highly compensated common-law employees must be disregarded. This equivalent alternative compensation amount will be treated as compensation determined using the alternative definition of compensation.

(ii) *Inclusion of elective contributions.* If the alternative definition of compensation includes any types of elective contributions described in paragraph (c)(4) of this section, the self-employed individual's earned income for this determination must be increased by the amount of elective contributions made by the employer on behalf of the self-employed individual, and the definition of total compensation for this determination must include all the types of elective contributions described in paragraph (c)(4) of this section made by the employer on behalf of common-law employees (other than highly compensated employees).

(2) *Leased employees.* [Reserved]

(f) The Commissioner may in revenue rulings, notices, and other guidance of general applicability provide additional rules for defining compensation within the meaning of section 414(s), including additional definitions of compensation that satisfy section 414(s).

(g) *Effective date*—(1) *General effective date.* This §1.414(s)-1T applies to years beginning on or after January 1, 1987.

(2) *Optional use of prior regulations.* For years beginning before May 14, 1990, employers may, in defining compensation for purposes of section 414(s), comply with either the provisions of this §1.414(s)-1T or the prior regulation provisions of §1.414(s)-1T. See 26 CFR §1.414(s)-1T (revised as of April 1, 1989).

Par. 3. Section 1.415-2, paragraphs (d)(1), (d)(4), and the last sentence of paragraph (d)(6) are revised, paragraph (d)(8) is redesignated as paragraph (d)(10), paragraphs (d)(11) and (d)(12) are added, paragraph (d)(8) is added and reserved, and paragraph (d)(9) is added and reserved.

§1.415-2 Definitions and special rules.

* * * * *

(d) *Compensation*—(1) *Items includable as compensation.* For purposes of applying the limitations of

section 415, the term "compensation" includes—

(i) The participant's wages, salaries, fees for professional service and other amounts received (without regard to whether or not an amount is paid in cash) for personal services actually rendered in the course of employment with the employer maintaining the plan to the extent that the amounts are includable in gross income (including, but not limited to, commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, bonuses, fringe benefits, reimbursements, and expense allowances).

(ii) In the case of a participant who is an employee within the meaning of section 401(c)(1) and the regulations thereunder, the participant's earned income (as described in section 401(c)(2) and the regulations thereunder).

(iii) Amounts described in section 104(a)(3), 105(a) and 105(h), but only to the extent that these amounts are includable in the gross income of the employee.

(iv) Amounts paid or reimbursed by the employer for moving expenses incurred by an employee, but only to the extent that these amounts are not deductible by the employee under section 217.

(v) The value of a non-qualified stock option granted to an employee by the employer, but only to the extent that the value of the option is includable in the gross income of the employee for the taxable year in which granted.

(vi) The amount includable in the gross income of an employee upon making the election described in section 83(b).

Paragraphs (d)(1)(i) and (d)(1)(ii) of this section include foreign earned income (as defined in section 911(b)), whether or not excludable from gross income under section 911.

* * * * *

(4) *Election to use compensation accrued during limitation year*—(i) *Years beginning after December 31, 1991.* For limitation years beginning after December 31, 1991, an employer may not use accrued compensation. Any election previously made to use accrued compensation is not valid for limitation years beginning after December 31, 1991.

(ii) *De minimis accrued compensation.* Notwithstanding paragraph (d)(4)(i) of this section, an employer may include in compensation amounts earned but not paid in a year because of the timing of pay periods and pay days if these amounts are paid during the first few weeks of the next year, the amounts are included on a uniform and consistent basis with respect to all similarly situated employees, and no compensation is included in more than one limitation period. No formal election is required to include the accrued compensation permitted under this de minimis rule. The rule described in this paragraph (d)(4)(ii) does not apply to a section 403(b) annuity contract or to an individual retirement plan (as described in section 7701(a)(37)).

(iii) *Years beginning before January 1, 1992.* For limitation years beginning before January 1, 1992, instead of using the compensation actually paid or made available to a participant during the limitation year, an employer may elect to use the compensation accrued for an entire limitation year for purposes of applying the limitations of section 415. In the case of a group of employers which constitute either a controlled group of corporations (within the meaning of section 414(b) as modified by section 415(h)) or trades or businesses (whether or not incorporated) which are under common control (within the meaning of section 414(c) as modified by section 415(h)), the election to use accrued compensation must be made by all members of the group that maintain a qualified plan. Once an election is made, it remains in effect until it is revoked by the employer or group of employers. The election is made or revoked by the adoption of a written resolution by the employer or group of employers. The written resolution requirement described in the preceding sentence is satisfied if the election is made in connection with the adoption, by the employer, or employers, of the plan or any amendments to such plan. The rule described in this paragraph (d)(4)(iii) does not apply to a section 403(b) annuity contract or to an individual retirement plan (as described in section 7701(a)(37)).

* * * * *

(6) *Special rule for employees of controlled groups of corporations, etc.* * * * This special rule is also applicable to an employee of two or more trades or businesses (whether or not incorporated) that are under common control (as defined in section 414(c) as modified by section 415(h)), to an employee of two or more members of an affiliated service group as defined in section 414(m), and to an employee of two or more members of any group of employers who must be aggregated and treated as one employer pursuant to section 414(o).

* * * * *

(8) *Special rules for leased employees.* [Reserved]

(9) *Special rules for permanent and total disability.* [Reserved]

(10) *Safe-harbor rule with respect to plan's definition of compensation.* * * *

(11) *Alternative definition of compensation.* In lieu of defining compensation in accordance with paragraph (d)(1) and (d)(2) of this section, for purposes of applying the limitations of section 415 in the case of employees other than employees within the meaning of section 401(c)(1), a plan may define compensation using either of the following definitions used for employment tax purposes, as modified herein, and the definition will be considered automatically to satisfy section 415(c)(3):

(i) *Section 3121(a) wages.* Wages as defined in section 3121(a), for purposes of calculating social security taxes, but determined without regard to the wage base limitation in section 3121(a)(1), the limitations on the exclusions from wages in section 3121(a)(5)(C) and (D) for elective contributions and payments by reason of salary reduction agreements, the special rules in section 3121(v) (applicable to certain elective contributions and nonqualified deferred compensation), any rules that limit covered employment based on the type or location of an employee's employer, and any rules that limit the remuneration included in wages based on familial relationship or based on the nature or location of the employment

or the services performed (such as the exceptions to the definition of employment in section 3121(b)(1) through (20)).

(ii) *Section 3401(a) wages.* Wages as defined in section 3401(a) for purposes of income tax withholding at the source but determined without regard to any rules that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in section 3401(a)(2)).

(12) The Commissioner may in revenue rulings, notices, and other guidance of general applicability provide additional definitions of compensation that are treated as satisfying section 415(c)(3).

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. Section 414(s) is generally applicable to provisions that refer to it for years beginning on or after January 1, 1987. Section 414(s) permits an employer to use a definition of compensation other than the definition provided in section 415(c)(3) to satisfy an applicable provision only if the alternative definition is prescribed by regulations. It is therefore found impracticable and contrary to the public interest to issue this Treasury decision with notice and public procedure under section 553(b) of Title 5 of the United States Code or subject to the effective date limitations of section 553(d) of that title.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved March 30, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 10, 1990, 8:45 a.m., and published in the issue of the Federal Register for May 14, 1990, 55 F.R. 19875)

Subchapter E.—Accounting Periods and Methods of Accounting

Part II.—Methods of Accounting

Subpart A.—Methods of Accounting in General

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-1: General rule for methods of accounting.

A taxpayer may not, without the Commissioner's consent, retroactively change from an erroneous to a permissible method of accounting by filing amended returns, even if the period for amending the return for the first year in which the erroneous method was used has not expired. See Rev. Rul. 90-38, page 57.

Subpart B.—Taxable Year for Which Items of Gross Income Included

Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451-6T: Election to include crop insurance proceeds in gross income in the taxable year following the taxable year of destruction or damage (temporary).

T.D. 8289

DEPARTMENT OF TREASURY
Internal Revenue Service
26 CFR Part 1

General Rule for Taxable Year of Inclusion—Election to Include Crop Insurance Proceeds in Gross Income in the Taxable Year Following the Taxable Year of Destruction or Damage

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations clarifying the applicability of section 451(d) of the Internal Revenue Code (regarding the taxable year of inclusion for crop insurance proceeds) to certain federal payments made to farmers. The text of the temporary regulations set forth in this document also serves as the text of the proposed regulations for the notice of proposed rulemaking on this subject in *** [IA-012-90, page 678, this Bulletin].

EFFECTIVE DATE: The temporary regulations contained in §1.451-6T are effective for payments received after December 31, 1973.

SUPPLEMENTARY INFORMATION:

Issuance of Proposed Regulation

The rules contained in this document are also being issued as proposed regulations by the notice of proposed rulemaking on this subject in *** [IA-012-90, page 678, this Bulletin].

Background

This document contains temporary Income Tax Regulations (26 CFR Part 1) that provide rules relating to the applicability of section 451(d) of the Internal Revenue Code to certain federal payments. Section 451(d) of the Code was enacted as part of the Tax Reform Act of 1969 [Pub. L. 91-172, 1969-3 C.B. 10] to ameliorate the tax burden on a farmer who, in the same year, would otherwise have to pay tax on both (a) the proceeds of crops grown during the previous year and sold during the current year and (b) the insurance proceeds received during the current year with respect to the destruction of, or damage to, crops that would have been sold the following year. Prior to the Tax Reform Act of 1969, crop insurance proceeds were included in income for the year of receipt in the case of taxpayers using a cash method of accounting. Congress recognized that such a rule resulted in a hardship where it was the normal practice of the farmer to sell a crop in the year following that in which the crop was raised. In that case the farmer normally would include the proceeds from the sale of the prior year's crop in income for the taxable year of sale and would include the proceeds from the sale of the current year's crop in income for the following year when the crop was sold. If, however, the current year's crop was damaged or destroyed (for instance by hail or windstorm), the farmer was required to include any insurance proceeds in income for the current year. Thus, two years of income had to be reported in the current year as a result of an occurrence over which the farmer had no control. Congress was of the view that the likely net operating loss in the subsequent year that could be carried back was not an adequate solution to the problem.

Payments made by the Federal Government with respect to the destruction of or damage to crops caused by natural disaster serve the identical function of insurance proceeds received for similar purposes, and have the same tax effects on the recipient. Although Congress has specifically enumerated certain disaster relief payments that qualify as "insurance proceeds" (see *e.g.*, Pub. L. 94-455, [1976-3 C.B. (Vol. 1) 1]

§§2102(a), (b), 1906(b)(13)(A); Pub. L. 100-647, §6033(a)), the Service believes that the interpretation set forth in the temporary regulations properly implements the intent with which section 451(d) was initially enacted. This determination is not intended to affect the meaning of the term "insurance" for purposes of any other provision of the Code.

Rev. Rul. 75-36, 1975-1 C.B. 143, which took a position inconsistent with that of the temporary regulations, will be revoked.

Explanation of Provisions

Under the regulations, federal payments received as a result of (a) destruction or damage to crops caused by drought, flood, or any other natural disaster or (b) the inability to plant crops because of such a natural disaster, shall be treated as insurance proceeds received as a result of destruction or damage to crops for purposes of section 451(d) of the Code.

Special Analyses

It has been determined that these temporary rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Amendments to the Regulations

The amendments to 26 CFR, Part 1, are as follows:

PART 1—INCOME TAX REGULATIONS

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805 ***

Par. 2. New section 1.451-6T is added to read as follows:

§1.451-6T. Election to include crop insurance proceeds in gross income in the taxable year following the taxable year of destruction or damage (Temporary).

(a) *In general.* (1) For taxable years ending after December 30, 1969, a taxpayer reporting gross income on the cash receipts and disbursements method of accounting may elect to include insurance proceeds received as a result of the destruction of, or damage to, crops in gross income for the taxable year following the taxable year of such destruction or damage, if the taxpayer establishes that, under the taxpayer's normal business practice, the income from such crops would have been included in gross income for any taxable year following the taxable year of such destruction or damage. However, if the taxpayer receives such insurance proceeds in the taxable year following the taxable year of such destruction or damage, then the taxpayer shall include such proceeds in gross income for the taxable year of receipt without having to make an election under section 451(d) and this section. For the purposes of this section only, federal payments received as a result of

(i) destruction or damage to crops caused by drought, flood, or any other natural disaster, or

(ii) the inability to plant crops because of such a natural disaster, shall be treated as insurance proceeds received as a result of destruction or damage to crops. The preceding sentence shall apply to payments which are received by the taxpayer after December 31, 1973.

(2) For special rules pertaining to the destruction of, or damage to, two or more specific crops, see §1.451-6(a)(2).

(b) (1) *Time and manner of making election.* For rules pertaining to the time and manner of making the election under section 451(d) and this section, see §1.451-6(b)(1).

(2) *Scope of election.* For specific rules pertaining to the scope of an election under section 451(d) and this section, see §1.451-6(b)(2).

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved February 15, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 23, 1990, 4:28 p.m., and published in the issue of the Federal Register for March 1, 1990, 55 F.R. 7316)

Section 453—Installment Method

26 CFR 15a.453-1: Installment method reporting for sales of real property and casual sales of personal property.

Late elections out of the installment method. Guidance is provided concerning whether the Service will grant permission to make a late election out of the installment method under section 15a.453-1(d)(3)(ii) of the temporary regulations.

Rev. Rul. 90-46

ISSUE

If a taxpayer fails to make a timely election out of the installment method of reporting gain from an installment sale of property, will the Internal Revenue Service ("IRS") grant permission for the taxpayer to make a late election out of the installment method in the situations described below?

FACTS

Situation 1. In 1985, taxpayer *A* sold real estate for cash and an installment note. Under the terms of the note, *A* is to receive monthly payments until 1995. On *A*'s 1985 federal income tax return, *A* used the installment method to report only part of the gain from the sale. *A* reported this gain as a long-term capital gain.

In the Tax Reform Act of 1986, Congress eliminated the 60 percent net capital gain deduction and reduced the maximum effective tax rate on the taxable income of individuals to 28 percent. These two changes, in combination, raised the maximum effective tax rate on net capital gains from 20 percent to 28 percent. Because of this increase in the maximum effective tax rate, *A* in 1987 properly requested permission from the IRS to elect out of the installment method of reporting the gain on the 1985 sale and to report the entire gain from

that sale on an amended 1985 federal income tax return.

Situation 2. In 1985, taxpayer *B* sold a personal residence for cash and a 10-year installment note. On *B*'s 1985 federal income tax return, *B* used the installment method to report only part of the gain from the sale. In 1986, *B* properly requested permission from the IRS to report the remainder of the gain on *B*'s 1986 federal income tax return. *B* based the request on a desire to simplify income tax reporting.

Situation 3. In 1985, *C*, an individual taxpayer, sold real property for cash and a five-year installment note. On January 15, 1986, *C* sent a letter to *D*, an accountant, who prepared *C*'s 1985 federal income tax return. In the letter, *C* instructed *D* to elect out of the installment method for the sale of real property and to report all the gain from such sale on *C*'s 1985 federal income tax return. *C* also sent *D* a power of attorney to sign the return as *C*'s agent because *C* was going to be out of the United States for at least the 60 days prior to the due date for *C*'s 1985 return. *D* signed and timely filed *C*'s return, but mistakenly did not elect out of the installment method for the sale of real property, and mistakenly used the installment method to report only part of the gain from such sale.

On returning to the United States in May 1986, *C* discovered *D*'s mistake on *C*'s 1985 return. Shortly thereafter, *C* requested permission from the National Office of the IRS to file an amended 1985 return to elect out of the installment method of reporting the gain on the 1985 sale of real property and to report all the gain from such sale on *C*'s amended 1985 return. Such request was in accordance with the applicable administrative procedures for requesting a private letter ruling that were in effect at the time of the request.

LAW AND ANALYSIS

Section 453(a) of the Internal Revenue Code of 1986 (the "Code") provides that income from an installment sale shall be taken into account under the installment method.

Section 453(b)(1) of the Code provides that an installment sale is a disposition of property where at least one payment is to be received after the close of the taxable year in which the disposition occurs.

Section 453(c) of the Code provides that the term "installment method" means a method under which the income recognized for any taxable year from a disposition is that proportion of the payments received in that year which the gross profit (realized or to be realized when payment is completed) bears to the total contract price.

Section 453(d)(1) of the Code provides that the installment method shall not apply to any sale if the taxpayer elects not to have the installment method apply to the sale. Section 453(d)(2) of the Code provides that, except as otherwise provided by regulations, an election out of the installment method may be made only on or before the due date prescribed by law (including extensions) for filing the taxpayer's return for the taxable year of the sale.

Section 15a.453-1(d)(2)(i) of the Temporary Income Tax Regulations ("temporary regulations") provides that a taxpayer who elects not to report an installment sale on the installment method must recognize gain on the sale in accordance with the taxpayer's method of accounting.

Section 15a.453-1(d)(3)(ii) of the temporary regulations provides that elections out of the installment method after the due date (including extensions) for filing the taxpayer's return for the taxable year in which the sale occurs will be permitted only in those rare circumstances when the IRS concludes that the taxpayer had good cause for failing to make a timely election

A request for permission to make an election out of the installment method, if made after the due date (including extensions) for filing the taxpayer's return for the taxable year in which the sale or other disposition occurs, must be mailed to the National Office of the IRS. In addition, such request must be in accordance with the applicable administrative procedures for requesting a private letter ruling that are in effect at the time of the request.

In *Situation 1*, when *A* reported gain from the sale of real estate in 1985 using the installment method on *A*'s 1985 federal income tax return, *A* may have based the decision on the then existing tax law. Moreover, *A* may not have considered the possibility that Congress would subsequently amend the tax law to eliminate the 60 percent net capital gain deduction and thus raise the maximum effective rate of tax on net capital gains. Congress made such an amendment to the tax law in 1986. As a result, *A*'s circumstances changed so that *A* could save tax by electing out of the installment method and reporting the entire gain from the sale of real property on an amended 1985 return. For purposes of section 15a.453-1(d)(3)(ii) of the temporary regulations, however, the IRS does not consider a subsequent change in circumstances or law to be a good cause for failing to make a timely election out of the installment method. Thus, the Service will not grant *A* permission to elect out of the installment method.

In *Situation 2*, *B* reported the sale of a personal residence using the installment method on *B*'s 1985 federal income tax return. *B* would have had simpler income tax reporting if *B* had elected out of the installment method and had reported all the gain from the sale on *B*'s 1985 return. In 1986, *B* wanted to simplify income tax reporting by reporting the remainder of the gain from the 1985 sale on *B*'s 1986 federal income tax return. For purposes of section 15a.453-1(d)-(3)(ii) of the temporary regulations, however, the IRS does not consider a taxpayer's change of mind to be good cause for failing to make a timely election out of the installment method. Thus, the Service will not grant *B* permission to elect out of the installment method.

In *Situation 3*, when *C*'s 1985 federal income tax return was timely filed, *C* intended to elect out of the installment method for reporting gain from the real property *C* sold in 1985. *C*'s agent, however, mistakenly did not make the timely election out of the installment method on *C*'s 1985 federal income tax return. Upon learning of the mistake and within a reasonable time after the return was filed, *C* properly requested permission from the National Office of the IRS to make the election out of the installment method of reporting the gain on the 1985 sale of real property. Such request was in accordance with the applicable administrative

procedures for requesting a private letter ruling that were in effect at the time of the request.

If a taxpayer's intention to timely elect out of the installment method is thwarted by a mistake and the taxpayer makes a timely effort to correct the mistake, the Service may consider this one of the rare circumstances in which the taxpayer has good cause for failing to make a timely election out of the installment method. In *Situation 3*, *C* had written documentation, executed before *C*'s timely filed 1985 federal income tax return, that showed that *C* intended to timely elect out of the installment method of reporting the gain on 1985 sale of real property. Thus, subject to the discretion of the Commissioner and after considering all of the relevant facts, the Service may grant *C* permission to elect out of the installment method by filing an amended 1985 federal income tax return.

HOLDING

In *Situations 1* and *2*, the Service will not grant permission for the taxpayers to make a late election out of the installment method. In *Situation 3*, the Service may grant permission for the taxpayer to make a late election out of the installment method.

Subpart C.—Taxable Year for Which Deductions Taken

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth in the month of January 1990. See Rev. Rul. 90-1, page 155.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1990. See Rev. Rul. 90-12, page 156.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth in the month of March 1990. See Rev. Rul. 90-22, page 158.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 1990. See Rev. Rul. 90-28, page 159.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1990. See Rev. Rul. 90-41, page 161.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 1990. See Rev. Rul. 90-48, page 162.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1990. See Rev. Rul. 90-1, page 155.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1990. See Rev. Rul. 90-12, page 156.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1990. See Rev. Rul. 90-22, page 158.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 1990. See Rev. Rul. 90-28, page 159.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1990. See Rev. Rul. 90-41, page 161.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 1990. See Rev. Rul. 90-48, page 162.

Section 469.—Passive Activity Losses and Credits Limited

26 CFR 1.469-2T: Passive activity loss (temporary).

T.D. 8290

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Limitations on Passive Activity Losses and Credits—Miscellaneous

AGENCY: Internal Revenue Service, Treasury.

ACTION: Amendments of temporary regulations.

SUMMARY: This document amends the temporary regulations relating to the limitations on passive activity losses and passive activity credits. The amendments respond to questions concerning the treatment of losses resulting from recent natural disasters by providing that the limitations do not apply to certain casualty and theft losses. The text of the temporary regulations also serves as the text of the proposed regulations for the notice of proposed rulemaking on this subject. The notice of proposed rulemaking appears in *** [PS-065-89, page 681, this Bulletin].

EFFECTIVE DATE: These regulations are effective for taxable years beginning after December 31, 1986.

SUPPLEMENTARY INFORMATION:

Background

The Internal Revenue Service has issued two installments of temporary regulations under section 469 of the Code (T.D. 8175, 53 FR 5686, February 25, 1988, [1988-1 C.B. 191] and T.D. 8253, 54 FR 20527, May 12, 1989, [1989-1 C.B. 121]. Section 1.469-2T provides rules for computing the passive activity loss for the taxable year. This document amends §1.469-2T in certain respects.

Amendments of §1.469-2T

I. Treatment of casualty and theft losses.

The Internal Revenue Service has determined that section 469 of the Code should not limit the deductibility of certain casualty and theft losses. Accordingly, these amendments of the regulations add the losses to the list of nonpassive deductions in §1.469-2T(d)(2). This exemption from the section 469 limitations applies only to losses that arise from fire, storm, shipwreck, or other casualty, or from theft, as those terms are used in section 165(c)(3). In addition, the exemption does not apply if losses that are similar in cause and severity recur regularly in the conduct of the activity. Thus, section 469 will not

limit losses such as those resulting from recent natural disasters, but may disallow shoplifting losses of a retail store, accident losses typically sustained in the operation of a fleet of rental automobiles, and other similar losses that recur regularly in the conduct of an activity.

The exemption for casualty and theft losses applies to all taxpayers subject to section 469. For losses sustained in taxable years beginning before January 1, 1990, however, the rule is elective and taxpayers may continue to treat the losses as passive activity deductions.

These amendments of the regulations also add a new exclusion from passive activity gross income to the list contained in §1.469-2T(c)(7). The new exclusion applies only to casualty and theft loss reimbursements that are included in gross income under §1.165-1(d)(2)(iii) and only if the deduction for the loss was not a passive activity deduction. Any other gross income attributable to reimbursements will continue to be included in or excluded from passive activity gross income under the rules contained in the existing regulations. The amendments of the regulations provide this exclusion because reimbursements are included in gross income under §1.165-1(d)(2)(iii) only to the extent necessary to offset the tax benefit of any deduction that the taxpayer claimed with respect to the loss. Applying the same principle to computations under section 469, the amount included in gross income under §1.165-1(d)(2)(iii) should not be treated as passive activity gross income if the deduction for the loss was excluded from passive activity deductions.

II. Treatment of capital loss carrybacks and carryovers.

These amendments of the regulations eliminate a disparity in the treatment of capital loss carryovers and carrybacks under section 469. If a corporation has a net capital loss for a taxable year, the amount of the loss generally is a capital loss carryback to each of the three taxable years preceding the loss year and a capital loss carryover to each of the five taxable years succeeding the loss year. Before its amendment by these regulations, §1.469-2T(d)(2)(ix) excluded capital loss carryovers but not carrybacks from passive activity deductions. Under §1.469-2T(d)(2)(ix) as amended by these regulation, both capital loss carryovers and carrybacks are excluded from passive activity deductions.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required.

* * * * *

Adoption of amendments to the regulations

Accordingly, Title 26, Chapter 1, Part 1 of the Code of Federal Regulations is amended as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953.

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805. *** Sections 1.469-1T, 1.469-2T, 1.469-3T, 1.469-5T, and 1.469-11T also issued under 26 U.S.C. 469(l).

Par. 2. Section 1.469-2T is amended as follows:

1. Paragraphs (c)(7)(iv) and (v) are revised, and the introductory text of paragraph (c)(7) is republished.

2. A new paragraph (c)(7)(vi) is added.

3. Paragraphs (d)(2)(ix) and (d)(2)(x) are revised, and the introductory text of paragraph (d)(2) is republished.

4. A new paragraph (d)(2)(xi) is added.

The revised and added provisions read:

§1.469-2T Passive activity loss (temporary).

* * * * *

(c) *Passive activity gross income*—***

(7) *Other items specifically excluded.* Notwithstanding any other provision of the regulations under section 469, passive activity gross income does not include the following:

* * * * *

(iv) Gross income of an individual from a covenant by such individual not to compete;

(v) Gross income that is treated as not from a passive activity under any provision of the regulations under section 469, including but not limited to §1.469-1T(h)(6) (relating to income from intercompany transactions of members of an affiliated group of corporations filing a consolidated return) and paragraph (f) of this section (relating to recharacterized passive income); and

(vi) Gross income attributable to the reimbursement of a loss from fire, storm, shipwreck, or other casualty, or from theft (as such terms are used in section 165(c)(3)) if—

(A) The reimbursement is included in gross income under §1.165-1(d)-(2)(iii) (relating to reimbursements of losses that the taxpayer deducted in the prior taxable year); and

(B) The deduction for the loss was not a passive activity deduction.

(d) *Passive activity deductions*—***

(2) *Exceptions.* Passive activity deductions do not include—

* * * * *

(ix) An item of loss or deduction that is carried to the taxable year under section 172(a), section 1212(a)(1) (in the case of corporations), or section 1212(b) (in the case of taxpayers other than corporations);

(x) An item of loss or deduction that would have been allowed for a taxable year beginning before January 1, 1987, but for section 704(d), 1366, or 465; and

(xi) A deduction for a loss from fire, storm, shipwreck, or other casualty, or from theft (as such terms are used in section 165(c)(3)) if losses that are similar in cause and severity do not recur regularly in the conduct of the activity and the taxpayer—

(A) Sustains the loss during a taxable year beginning after December 31, 1989; or

(B) Sustains the loss during a taxable year beginning before January 1, 1990, and treats the deduction as a deduction that is not from a passive activity on the taxpayer's return (or amended return) for such taxable year.

* * * * *

There is need for immediate guidance with respect to the provisions contained in this Treasury decision.

For this reason, it is impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved February 13, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 23, 1990, 8:45 a.m., and published in the issue of the Federal Register for February 28, 1990, 55 F.R. 6980)

Subpart D.—Inventories

Section 472.—Last-in, First-out Inventories

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The October 1989 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, October 31, 1989.

Rev. Rul. 90-6

The following price indexes for October 1989 were issued by the Bureau of Labor Statistics on November 24, 1989, for use by department stores, and are accepted by the Internal Revenue Service, under section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 86-46, 1986-2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, October 31, 1989.

Indexes are prepared on a national basis for the store total, for 23 major groups of departments, and for three special combinations—soft goods, durable goods and miscellaneous goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100 unless otherwise noted)

Groups	October 1988	October 1989	Percent Change from October 1988 to October 1989[1]
1. Piece Goods	416.4	412.2	−1.0
2. Domestics and Draperies	606.4	603.5	−0.5
3. Women's and Children's Shoes	599.1	602.7	0.6
4. Men's Shoes	825.5	838.5	1.6
5. Infants' Wear	560.3	570.9	1.9
6. Women's Underwear	467.5	477.3	2.1
7. Women's Hosiery[2]	242.3	246.3	1.7
8. Women's and Girls' Accessories	508.5	534.1	5.0
9. Women's Outerwear and Girls' Wear	407.3	407.7	0.1
10. Men's Clothing	542.2	559.4	3.2
11. Men's Furnishings	525.8	537.2	2.2
12. Boys' Clothing and Furnishings	466.8	469.9	0.7
13. Jewelry	786.9	816.9	3.8
14. Notions	503.0	539.3	7.2
15. Toilet Articles and Drugs	714.1	742.7	4.0
16. Furniture and Bedding	586.3	587.2	0.2
17. Floor Coverings	502.9	508.5	1.1
18. Housewares	730.2	732.2	0.3
19. Major Appliances	249.1	245.5	−1.4
20. Radio and Television	94.3	92.2	−2.2
21. Recreation and Education[3]	107.4	108.9	1.4
22. Home Improvements[3]	105.1	110.5	5.1
23. Auto Accessories[3]	102.8	105.1	2.2
Groups 1—15: Soft Goods	539.1	547.7	1.6
Groups 16—20: Durable Goods	452.3	450.0	−0.5
Groups 21—23: Misc. Goods[3]	106.1	108.4	2.2
Store Total	509.2	515.3	1.2

[1] Absence of a minus sign before percentage change in this column signifies price increase.
[2] Title reflects change in item sampling structure made during 1978 CPI Revision whereby Girls' Hosiery was included in Group 8, Women's and Girl's Accessories, not Group 7.
[3] Indexes on a January 1986 = 100 base

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The November 1989 Bureau of Labor Statisticsprice indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, November 30, 1989.

Rev. Rul. 90-14

The following price indexes for November 1989 were issued by the Bureau of Labor Statistics on December 21, 1989, for use by department stores, and are accepted by the Internal Revenue Service, under section 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86-46, 1986-2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, November 30, 1989.

Indexes are prepared on a national basis for the store total, for 23 major groups of departments, and for three special combinations—soft goods, durable goods and miscellaneous goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES
BY DEPARTMENT GROUPS
(January 1941 = 100 unless otherwise noted)

Groups	November 1988	November 1989	Percent Change from November 1988 to November 1989[1]
1. Piece Goods	417.0	415.9	-0.3
2. Domestics and Draperies	595.9	603.0	1.2
3. Women's and Children's Shoes	590.5	596.2	1.0
4. Men's Shoes	828.2	839.3	1.3
5. Infants' Wear	558.4	565.7	1.3
6. Women's Underwear	476.2	481.8	1.2
7. Women's Hosiery	243.8	249.0	2.1
8. Women's and Girls' Accessories	504.1	536.5	6.4
9. Women's Outerwear and Girls' Wear	401.0	401.9	0.2
10. Men's Clothing	541.4	561.4	3.7
11. Men's Furnishings	528.8	544.6	3.0
12. Boys' Clothing and Furnishings	473.7	466.9	-1.4
13. Jewelry	780.1	820.1	5.1
14. Notions	511.3	541.3	5.9
15. Toilet Articles and Drugs	718.3	748.2	4.2
16. Furniture and Bedding	591.2	580.0	-1.9
17. Floor Coverings	500.7	512.4	2.3
18. Housewares	734.5	736.3	0.2
19. Major Appliances	251.6	246.9	-1.9
20. Radio and Television	93.8	93.2	-0.6
21. Recreation and Education[2]	107.9	109.2	1.2
22. Home Improvements[2]	105.1	111.3	5.9
23. Auto Accessories[2]	102.9	105.3	2.3
Groups 1—15: Soft Goods	536.4	547.1	2.0
Groups 16—20: Durable Goods	454.2	451.7	-0.6
Groups 21—23: Misc. Goods[2]	106.4	108.7	2.2
Store Total	508.5	515.8	1.4

[1] Absence of a minus sign before percentage change in this column signifies price increase.
[2] Indexes on a January 1986 = 100 base

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The December 1989 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, December 31, 1989.

Rev. Rul. 90-30

The following price indexes for December 1989 were issued by the Bureau of Labor Statistics on January 22, 1990, for use by department stores, and are accepted by the Internal Revenue Service, under section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 86-46, 1986-2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, December 31, 1989.

Indexes are prepared on a national basis for the store total, for 23 major groups of departments, and for three special combinations—soft goods, durable goods and miscellaneous goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS

(January 1941 = 100 unless otherwise noted)

Groups	December 1988	December 1989	Percent Change from December 1988 to December 1989[1]
1. Piece Goods	411.9	443.3	7.6
2. Domestics and Draperies	595.0	594.4	-0.1
3. Women's and Children's Shoes	584.5	583.0	-0.3
4. Men's Shoes	823.8	839.0	1.8
5. Infants' Wear	558.0	558.2	0.0
6. Women's Underwear	473.7	479.0	1.1
7. Women's Hosiery	246.6	250.1	1.4
8. Women's and Girls' Accessories	505.3	534.7	5.8
9. Women's Outerwear and Girls' Wear	387.4	383.3	-1.1
10. Men's Clothing	537.3	550.4	2.4
11. Men's Furnishings	525.2	532.3	1.4
12. Boys' Clothing and Furnishings	469.8	462.7	-1.5
13. Jewelry	779.1	811.5	4.2
14. Notions	518.2	534.2	3.1
15. Toilet Articles and Drugs	723.1	744.7	3.0
16. Furniture and Bedding	587.4	577.1	-1.8
17. Floor Coverings	488.5	508.2	4.0
18. Housewares	732.9	733.4	0.1
19. Major Appliances	250.1	244.0	-2.4
20. Radio and Television	93.6	93.3	-0.3
21. Recreation and Education[2]	107.5	109.2	1.6
22. Home Improvements[2]	105.6	110.7	4.8
23. Auto Accessories[2]	103.6	105.5	1.8
Groups 1 - 15: Soft Goods	531.0	535.9	0.9
Groups 16 - 20: Durable Goods	452.0	449.5	-0.6
Groups 21 - 23: Misc. Goods[2]	106.4	108.7	2.2
Store Total[3]	505.0	509.1	0.8

[1]Absence of a minus sign before percentage change in this column signifies price increase.
[2]Indexes on a January 1986 = 100 base.
[3]The store total index covers all departments, with the following exceptions: Candy, foods, liquor, tobacco, as well as contract departments.

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The January 1990 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, January 31, 1990.

Rev. Rul. 90-33

The following price indexes for January 1990 were issued by the Bureau of Labor Statistics on February 23, 1990, for use by department stores, and are accepted by the Internal Revenue Service, under section 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86-46, 1986-2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, January 31, 1990.

Indexes are prepared on a national basis for the store total, for 23 major groups of departments, and for three special combinations—soft goods, durable goods and miscellaneous goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS (January 1941 = 100 unless otherwise noted)

Groups	January 1989	January 1990	Percent Change from January 1989 to January 1990[1]
1. Piece Goods	409.8	452.0	10.3
2. Domestics and Draperies	591.2	594.8	0.6
3. Women's and Children's Shoes	570.7	570.1	-0.1
4. Men's Shoes	832.4	841.4	1.1
5. Infants' Wear	553.0	549.8	-0.6
6. Women's Underwear	466.2	470.7	1.0
7. Women's Hosiery	246.4	250.9	1.8
8. Women's and Girls' Accessories	504.2	520.7	3.3
9. Women's Outerwear and Girls' Wear	367.9	364.9	-0.8
10. Men's Clothing	527.0	534.9	1.5
11. Men's Furnishings	517.9	525.5	1.5
12. Boys' Clothing and Furnishings	457.8	445.8	-2.6
13. Jewelry	785.3	819.7	4.4
14. Notions	522.3	540.7	3.5
15. Toilet Articles and Drugs	724.0	747.7	3.3
16. Furniture and Bedding	586.8	584.7	-0.4
17. Floor Coverings	508.7	508.2	-0.1
18. Housewares	735.6	735.4	0.0
19. Major Appliances	248.8	243.9	-2.0
20. Radio and Television	94.6	92.5	-2.2
21. Recreation and Education[2]	107.8	109.4	1.5
22. Home Improvements[2]	105.9	112.0	5.8
23. Auto Accessories[2]	104.2	105.4	1.2
Groups 1—15: Soft Goods	521.3	526.2	0.9
Groups 16—20: Durable Goods	454.1	450.2	-0.9
Groups 21—23: Misc. Goods[2]	106.7	109.0	2.2
Store Total[3]	500.6	504.3	0.7

1 Absence of a minus sign before percentage change in this column signifies price increase.
2 Indexes on a January 1986 = 100 base.
3 The store total index covers all departments, with the following exceptions: Candy, foods, liquor, tobacco, as well as contract departments.

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The February 1990 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, February 28, 1990.

Rev. Rul. 90-39

The following price indexes for February 1990 were issued by the Bureau of Labor Statistics on March 22, 1990, for use by department stores, and are accepted by the Internal Revenue Service, under section 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, February 28, 1990.

Indexes are prepared on a national basis for the store total, for 23 major groups of departments, and for three special combinations—soft goods, durable goods and miscellaneous goods.

The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100 unless otherwise noted)

Groups	February 1989	February 1990	Percent Change from February 1989 to February 1990[1]
1. Piece Goods	418.3	459.2	9.8
2. Domestics and Draperies	607.9	614.3	1.1
3. Women's and Children's Shoes	577.4	580.4	0.5
4. Men's Shoes	831.0	841.6	1.3
5. Infants' Wear	564.5	587.8	4.1
6. Women's Underwear	470.8	472.7	0.4
7. Women's Hosiery	245.3	251.6	2.6
8. Women's and Girls' Accessories	502.3	525.4	4.6
9. Women's Outerwear and Girls' Wear	367.4	384.8	4.7
10. Men's Clothing	526.4	546.4	3.8
11. Men's Furnishings	520.4	532.0	2.2
12. Boys' Clothing and Furnishings	442.6	434.0	−1.9
13. Jewelry	790.2	843.4	6.7
14. Notions	523.6	555.6	6.1
15. Toilet Articles and Drugs	726.2	750.4	3.3
16. Furniture and Bedding	580.8	584.9	0.7
17. Floor Coverings	492.0	514.2	4.5
18. Housewares	734.0	742.8	1.2
19. Major Appliances	251.1	245.5	−2.2
20. Radio and Television	94.1	92.9	−1.3
21. Recreation and Education[2]	107.8	110.3	2.3
22. Home Improvements[2]	108.3	109.8	1.4
23. Auto accessories[2]	104.4	105.8	1.3
Groups 1–15: Soft Goods	524.1	539.6	3.0
Groups 16–20: Durable Goods	452.4	453.3	0.2
Groups 21–23: Misc. Goods[2]	107.2	109.3	2.0
Store Total[3]	502.1	512.7	2.1

[1] Absence of a minus sign before percentage change in this column signifies price increase.
[2] Indexes on a January 1986 = 100 base.
[3] The store total index covers all departments, with the following exceptions: Candy, foods, liquor, tobacco, as well as contract departments.

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The March 1990 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, March 31, 1990.

Rev. Rul. 90–50

The following price indexes for March 1990 were issued by the Bureau of Labor Statistics on April 19, 1990, for use by department stores, and are accepted by the Internal Revenue Service, under section 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, March 31, 1990.

Indexes are prepared on a national basis for the store total, for 23 major groups of departments, and for three special combinations—soft goods, durable goods and miscellaneous goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100 unless otherwise noted)

Groups	March 1989	March 1990	Percent Change from March 1989 to March 1990[1]
1. Piece Goods	425.2	454.4	6.9
2. Domestics and Draperies	608.4	614.7	1.0
3. Women's and Children's Shoes	586.2	593.6	1.3
4. Men's Shoes	822.6	854.2	3.8
5. Infants' Wear	562.9	600.3	6.6
6. Women's Underwear	471.4	478.3	1.5
7. Women's Hosiery	242.1	252.3	4.2
8. Women's and Girls' Accessories	515.1	527.9	2.5
9. Women's Outerwear and Girls' Wear	394.7	418.2	6.0
10. Men's Clothing	537.3	557.1	3.7
11. Men's Furnishings	528.5	542.1	2.6
12. Boys' Clothing and Furnishings	441.5	443.6	0.5
13. Jewelry	789.7	857.4	8.6
14. Notions	523.7	557.8	6.5
15. Toilet Articles and Drugs	730.2	754.9	3.4
16. Furniture and Bedding	574.5	592.7	3.2
17. Floor Coverings	486.8	512.1	5.2
18. Housewares	722.6	740.6	2.5
19. Major Appliances	245.2	243.3	-0.8
20. Radio and Television	93.2	92.4	-0.9
21. Recreation and Education[2]	107.8	111.0	3.0
22. Home Improvements[2]	108.4	110.4	1.8
23. Auto Accessories[2]	103.4	105.4	1.9
Groups 1 - 15: Soft Goods	535.3	555.6	3.8
Groups 16 - 20: Durable Goods	445.7	452.4	1.5
Groups 21 - 23: Misc. Goods[2]	107.0	109.8	2.6
Store Total[3]	506.2	521.5	3.0

[1] Absence of a minus sign before percentage change in this column signifies price increase.
[2] Indexes on a January 1986 = 100 base.
[3] The store total index covers all departments, with the following exceptions: Candy, foods, liquor, tobacco, as well as contract departments.

Part III. Adjustments

Section 482.—Allocation of Income and Deductions Among Taxpayers

26 CFR 1.482-1: Allocation of income and deductions among taxpayers.

Guidelines are set forth regarding the disallowance, under section 265(b) of the Code, of interest expense allocable to tax-exempt obligations held by financial institutions. See Rev. Rul. 90-44, page 54.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1990. See Rev. Rul. 90-1, page 155.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1990. See Rev. Rul. 90-12, page 156.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1990. See Rev. Rul. 90-22, page 158.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 1990. See Rev. Rul. 90-28, page 159.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1990. See Rev. Rul. 90-41, page 161.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 1990. See Rev. Rul. 90-48, page 162.

Subchapter F.—Exempt Organizations

Part I.—General Rule

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(a)-1: Exemption from taxation.

Revised procedures are provided for issuing rulings and determination letters in response to applications for recognition of exemption from federal income tax. See Rev. Proc. 90-27, page 514.

Part II.—Private Foundations

Section 509.—Private Foundation Defined

26 CFR 1.509(a)-1: Definition of private foundation.

Revised procedures are provided for issuing rulings and determination letters in response to applications for recognition of exemption from federal income tax. See Rev. Proc. 90-27, page 514.

Part IV.—Farmers' Cooperatives

Section 521.—Exemption of Farmers' Cooperative from Tax

26 CFR 1.521-1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521.

Cooperative associations; exemption from tax; stock ownership. Rev. Rul. 77-440, 1977-2 C.B. 199, is revoked because it applies the 50-percent patronage test of Rev. Proc. 73-39, 1973-2 C.B. 502, that was revoked by Rev. Proc. 90-29.

Rev. Rul. 90-42

HOLDING

Rev. Rul. 77-440, 1977-2 C.B. 199, discussed situations where the 50-percent patronage test of Rev. Proc. 73-39, 1973-2 C.B. 502, applied. Because Rev. Proc. 73-39 was revoked by Rev. Proc. 90-29, page 533, this Bulletin, Rev. Rul. 77-440 is revoked.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 77-440 is revoked.

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26 CFR 1.521-1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521.

Revised procedures are provided for issuing rulings and determination letters in response to applications for recognition of exemption from federal income tax. See Rev. Proc. 90-27, page 514.

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26 CFR 1.521-1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521.

Rev. Proc. 73-39, 1973-2 C.B. 502, is revoked. See Rev. Proc. 90-29, page 533.

Subchapter H.—Banking Institutions

Part I.—Rules of General Application to Banking Institutions

Section 585.—Reserves for Losses on Loans of Banks

Guidelines are set forth regarding the disallowance, under section 265(b) of the Code, of interest expense allocable to tax-exempt obligations held by financial institutions. See Rev. Rul. 90-44, page 54.

Subchapter I.—Natural Resources

Part I.—Deductions

Section 616.—Development Expenditures

26 CFR 1.616-1: Development expenditures.

The taxpayer may deduct all amounts it paid or incurred prior to payout that qualify as exploration expenditures under section 617(a) of the Code if it has made a proper election under that section. The taxpayer also may deduct all amounts it paid or incurred prior to payout that qualify as development expenditures under section 616(a). See Rev. Rul. 90-20, below.

Section 617.—Deduction and Recapture of Certain Mining Exploration Expenditures

26 CFR 1.617-1: Exploration expenditures. (Also Section 616; 1.616-1.)

Carrying party's costs to explore, develop, and operate a mineral property; deductibility. The taxpayer may deduct all amounts it paid or incurred prior to payout that qualify as exploration expenditures under section 617(a) of the Code if it has made a proper election under that section. The taxpayer also may deduct all amounts it paid or incurred prior to payout that qualify as development expenditures under section 616(a).

Rev. Rul. 90-20

ISSUE

If a taxpayer agrees to explore, develop, and operate a mineral property in return for all income from the property until recoupment of its costs (payout), to what extent may the taxpayer deduct the exploration and development costs that it pays or incurs?

FACTS

Y agreed to assign to *X*, a mining company, an interest in a mineral

property in the United States. In return, *X* agreed to explore, develop, and operate the property. Under the agreement, *X*, the carrying party, bore all exploration, development, and operating costs. *X* was also entitled to 100 percent of the income from mining the property until payout, that is, until *X* recovered all costs incurred in exploring and developing the property and operating the mine to produce such an amount. *X* had no right to transfer any interest to a third party prior to payout. The agreement provided that after the payout period *X* would hold 51 percent of the operating interest and *Y*, the carried party, would hold 49 percent.

X explored the property and, after discovering a commercially marketable mineral deposit, developed and operated a mine on the property.

LAW AND ANALYSIS

Section 617(a) of the Code allows taxpayers to elect to deduct expenditures paid or incurred during the tax year for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (other than oil or gas or any mineral with respect to which a deduction for percentage depletion is not allowable under section 613) if the expenditures are paid or incurred before the beginning of the development stage of the mine. Expenditures deducted under section 617(a) are subject to recapture under section 617(b) when the mine reaches the producing stage, as well as in certain other circumstances.

Section 616(a) of the Code provides that, if the taxpayer does not elect otherwise, expenditures paid or incurred during the tax year for the development of a mine or other natural deposit (other than an oil or gas well) located within the United States are allowed as a deduction if they are paid or incurred after the existence of ores or minerals in commercially marketable quantitites has been disclosed.

Section 1.617-1(b)(3) of the Income Tax Regulations, with respect to exploration expenditures, and section 1.616-1(b)(3), with respect to development expenditures, provide that such expenditures paid or incurred by a taxpayer in connection with the acquisition of a fractional share of a working or operating interest are deductible only to the extent of the fractional interest acquired. Expenditures attributable to the remaining fractional share are considered as part of the cost of the interest acquired by the taxpayer and must be capitalized and recovered through depletion allowances.

Section 263(c) of the Code authorizes the Secretary to prescribe regulations under which taxpayers may elect to deduct intangible drilling and development costs in the case of oil and gas wells located within the United States. Section 1.612-4(a) of the regulations provides that taxpayers that hold a working or operating interest in an oil or gas property may elect to deduct intangible drilling and development costs they incur with respect to that property. If, however, any drilling or development project is undertaken for the grant or assignment of a fraction of the operating rights, only that part of the costs thereof that is attributable to that fractional interest is within the option; costs of the project to the extent allocable to fractions of the operating rights held by others must be capitalized as a depletable cost of the fractional interest acquired by the taxpayer.

In Rev. Rul. 71-207, 1971-1 C.B. 160, the taxpayer, the carrying party in a carried interest arrangement, agreed to pay all costs to drill, complete, equip, and operate a well on an oil and gas lease. The taxpayer was entitled to recoup its costs from the income attributable to the entire operating interest in the well. After payout, the taxpayer and the carried party each held an undivided one-half operating interest in the lease. Applying section 1.612-4(a) of the regulations, Rev. Rul. 71-207 concludes that because the taxpayer held the entire operating interest in the well during the complete payout period, the taxpayer was entitled to elect under section 263(c) of the Code to deduct as an expense all its intangible drilling and development costs, even though the taxpayer held only a fractional interest in the lease after payout. *See also* Rev. Rul. 69-332, 1969-1 C.B. 87, which reaches a similar result in the case of an oil and gas well completed and plugged as a dry hole. *Cf. United States v. Cocke*, 399 F.2d 433 (5th Cir. 1968), *cert. denied*, 394 U.S. 922 (1969) (in which the carried party was denied deductions for intangible drilling and development expenditures incurred by the carrying party prior to payout).

Under Rev. Rul. 71-207 and other rulings concerning the treatment of intangible drilling and development costs for oil and gas wells, the determination of the complete payout period requires an interpretation of the carried interest agreement and the performance of the parties under the agreement. As a general principle, the complete payout period ends when the gross income attributable to all of the operating mineral interests in the well (or wells in the case of agreements covering more than a single well) equals all expenditures for drilling and development (tangible and intangible) of such well(s) plus the cost of operating the well(s) to produce such an amount.

In the present situation, *X* paid or incurred all of the exploration, development, and production costs, and received all of the income from the property until *X* fully recovered its exploration and development costs as well as the related costs of production. Under the terms of the agreement, it was not possible for *Y* or another party to acquire a fractional operating interest prior to complete payout. Factually, *X*'s situation is similar to the situation of the carrying party in Rev. Rul. 71-207, except that Rev. Rul. 71-207 concerns oil and gas intangible drilling and development expenditures rather than mining exploration and development expenditures. With respect to the requirement that the taxpayer seeking a current deduction must hold an operating interest, and with respect to the rules that apply in the case of the acquisition of a fractional operating interest, the regulations regarding mining exploration and development expenditures are substantively the same as the regulations regarding intangible drilling and development costs. Because of these factual and legal similarities, *X*'s exploration and development costs should receive the same treatment as the taxpayer's intangible drilling and development costs in Rev. Rul. 71-207. Accordingly, for purposes of sections 1.617-1(b)(3) and 1.616-1(b)(3) of the regulations, *X* is considered to hold 100 percent of the operating interest in the mineral property through the complete payout period.

HOLDING

The taxpayer, *X*, may deduct all amounts it paid or incurred prior to payout that qualify as exploration expenditures under section 617(a) of the Code if it has made a proper election under that section. Also, *X* may deduct all amounts it paid or incurred prior to payout that qualify as development expenditures under section 616(a). These actions are permissible because *X* held 100 percent of the operating interest in the mineral property through the complete payout period. This ruling does not address the treatment of any unrecovered basis in equipment at the end of the payout period.

Subchapter J.—Estates, Trusts, Beneficiaries, and Decedents

Part I.—Estates, Trusts, and Beneficiaries

Subpart C.—Estates and Trusts Which May Accumulate Income or Which Distribute Corpus

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Section 664.—Charitable Remainder Trusts

26 CFR 1.664-2: Charitable remainder annuity trust.

Sample form of declaration of trust that meets the requirements of section 664(d)(1) of the Code for a charitable remainder annuity trust and provides for annuity payments during one or two measuring lives. See Rev. Proc. 90-32, page 546.

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26 CFR 1.664-2: Charitable remainder annuity trust.

The Service ordinarily will not issue rulings as to whether a charitable remainder trust that provides for annuity payments during one or two measuring lives meets the requirements of section 664(d)(1) of the Code. See Rev. Proc. 90-33, page 551.

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26 CFR 1.664-3: Charitable remainder unitrust.

Sample form of declaration of trust that meets the requirements of section 664(d)(2) of the Code for a charitable remainder unitrust and provides for unitrust payments during one or two measuring lives. See Rev. Proc. 90-30, page 534.

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26 CFR 1.664-3: Charitable remainder unitrust.

Sample form of declaration of trust that meets the requirements of section 664(d)(2) and (3) of the Code for a charitable remainder unitrust and provides for unitrust payments during one or two measuring lives. See Rev. Proc. 90-31, page 539.

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26 CFR 1.664-3: Charitable remainder unitrust.

The Service ordinarily will not issue rulings as to whether a charitable remainder trust that provides for unitrust payments during one or two measuring lives meets the requirements of section 664(d)(2) of the Code. See Rev. Proc. 90-33, page 551.

Subchapter K.—Partners and Partnerships

Part I.—Determination of Tax Liability

Section 708.—Continuation of Partnership

26 CFR 1.708-1: Continuation of partnership. (Also Section 761.)

Continuation of partnership. Section 761(e) of the Code does not cause the resulting partnership of a partnership merger to terminate under section 708. Rev. Ruls. 68-289 and 77-458 clarified.

Rev. Rul. 90-17

ISSUE

If a partnership resulting from a partnership merger is considered a continuation of one of the merging partnerships under section 708(b)(2)(A) of the Internal Revenue Code, do liquidating distributions by the other merging partnerships of 50 percent or more of the capital and profits interests in the resulting partnership cause the resulting partnership to terminate under section 708(b)(1)(B) because of the application of section 761(e)?

FACTS

A and *B* each owned a 50 percent interest in *RP*, a partnership having assets worth $500*x*. *B* and *C* each owned a 50 percent interest in *MP1*, a partnership having assets worth $400*x*. *D* and *E* each owned a 50 percent interest in *MP2*, a partnership having assets worth $100*x*. For business reasons independent of federal income tax consequences, the parties agreed to merge *RP*, *MP1*, and *MP2*. The merger was effected by each merging partnership contributing its assets to the resulting partnership in exchange for an interest in the resulting partnership. With respect to the interests in the resulting partnership *RP* received 50 percent, *MP1* received 40 percent, and *MP2* received 10 percent. The interests in the resulting partnership were then distributed proportionately to the respective partners of *RP*, *MP1* and MP2. After the merger transaction, the interests in the resulting partnership were held, 25 percent by *A*, 45 percent by *B*, 20 percent by *C*, and 5 percent each by *D* and by *E*.

LAW AND ANALYSIS

Section 708(a) of the Code provides that an existing partnership shall be considered as continuing until such time as it is deemed terminated under section 708(b).

Section 708(b)(1) of the Code provides rules of general application governing the termination of partnerships. Section 708(b)(1)(B) provides that a partnership shall be considered terminated if, within a 12-month period, there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

Section 708(b)(2) of the Code provides rules of special application governing the termination of partnerships involved in mergers, consolidations, and divisions. Section 708(b)(2)(A) provides that, in the case of a merger or consolidation of two or more partnerships, the resulting partnership shall be a continuation of any merging or consolidating partnership whose members own an interest of more than 50 percent in the capital and profits of the resulting partnership.

Section 1.708-1(b)(2)(i) of the Income Tax Regulations provide that, if a resulting partnership can, under section 708(b)(2)(A) of the Code, be considered a continuation of more than one of the merging or consolidating partnerships, it shall be considered the continuation of the partnership that is credited with the contribution of the greatest dollar value of assets to the resulting partnership. Any other merging or consolidating partnership shall be considered as terminated.

Section 761(e) of the Code, which was added by the Tax Reform Act of 1984, section 75(b), 1984-3 C.B. (Vol. 1) 1, 102, provides that, except as otherwise provided in regulations, for purposes of section 708, any distribution of an interest in a partnership (not otherwise treated as an exchange) shall be treated as an exchange.

In Rev. Rul. 68-289, 1968-1 C.B. 314, three partnerships, *P1*, *P2*, and

P3 are merged. All three partnerships have the same partners and, therefore, under section 708(b)(2)(A) of the Code, the partnership resulting from the merger could be treated as the continuations of either *P1*, *P2* or *P3*. However, because *P3* contributes the greatest dollar value of assets, the resulting partnership is considered the continuation of *P3*. *P1* and *P2* are treated as having first transferred their assets and liabilities to *P3* in exchange for partnership interests and then as having distributed the *P3* interests in liquidation.

Rev. Rul. 77-458, 1977-2 C.B. 220, considers the proposed merger of ten partnerships, *P1* - *P10*. These partnerships all have the same equal partners, *A* and *B*. Under the plan of merger *P2* - *P10* will transfer all of their assets and liabilities to *P1* (the largest partnership by dollar value of assets) in exchange for partnership interests in *P1*. *P2* - *P10* will then distribute their interests in *P1* to *A* and *B*. Rev. Rul. 77-458 concludes that the partnership resulting from the merger of *P1* - *P10* will be considered the continuation of *P1* because *P1* will contribute the greatest dollar value of assets to the resulting partnership.

Under section 708(b)(2)(A) of the Code, the partnership resulting from the merger of *RP*, *MP1*, and *MP2* can be considered the continuation of either *RP* or *MP1*. This is because both the members of *RP* (*A* and *B*) and the members of *MP1* (*B* and *C*) become the owners of more than 50 percent of the capital and profits interests in the resulting partnership. In accordance with section 1.708-1(b)(2)(i) of the regulations, however, the resulting partnership is the continuation of *RP*, the partnership that contributes the greatest dollar value of assets ($500x).

Consistent with the analysis in Rev. Rul. 68-289, *MP1* and *MP2* are considered to have contributed their assets to *RP* in exchange for ownership interests in *RP*. *MP1* and MP2 then liquidate and distribute their assets, the *RP* interests, to their partners. Because the *RP* partnership interests are received 40 percent by *MP1* and 10 percent by *MP2*, a total of 50 percent of the *RP* interests is distributed in the course of the merger. If section 761(e) of the Code causes the distributions to be treated as exchanges to which section 708(b)(1)(B) applies, *RP* will terminate.

The question thus presented is whether sections 761(e) and 708(b)(1)(B) of the Code have the effect of adding an additional requirement to section 708(b)(2)(A), namely, that fewer than 50 percent of the interests in the resulting partnership are distributed in the merger.

Section 708(b)(2)(A) of the Code applies only to mergers and consolidations. Together with section 1.708-1(b)(2)(i) of the regulations, it provides the exclusive means for deciding whether a partnership involved in a merger will terminate. Section 708(b)(2)(A) does not define the term "merger." However, as illustrated in Rev. Rul. 68-289 and Rev. Rul. 77-458, a merger includes the distribution by the terminating partnerships of interests in the resulting partnership. Thus, section 708(b)(2)(A) is a statute that creates a specific rule for a particular transaction, a merger, and that transaction includes the distribution of resulting partnership interests.

Paragraphs (1) and (2) of section 708(b) set forth, respectively, a general rule on the termination of partnerships and specific rules on partnership terminations where a partnership merger, consolidation, or division is involved. The specific rules are clearly exceptions to the general rule and intended to override the general rule in the limited circumstances to which they apply. Even if this relationship were not clear from the provisions themselves, a basic principle of statutory construction is that a specific statutory provision, like section 708(b)(2), is not controlled or nullified by a more general one, like section 708(b)(1), unless that result is clearly intended. *Bulova Watch Co. v. United States*, 365 U.S. 753 (1961). The legislative history of section 708(b)(1)(B) neither states nor implies a congressional intent that the provisions of section 708(b)(1)(B) take precedence over the partnership merger rules under section 708(b)(2)(A). *See* S. Rep. No. 1622, 83d Cong., 2d Sess. 388 (1954), and H.R. Rep. No. 2543, 83d Cong., 2d Sess. 61 (1954). Nor does the legislative history of section 761(e) state or imply a congressional intent to change the relationship between the provisions of sections 708(b)(1)(B) and 708(b)(2)(A). *See* H.R. Rep. No. 432, 98th Cong., 2d Sess. 1225-27 (1984), S. Prt. No. 169 (Vol. I), 98th Cong., 2d Sess. 236-38 (1984), and H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 863-65 (1984), 1984-3 C.B. (Vol. 2) 1, 117-19.

In other words, the purpose of the exception contained in section 708(b)(2)(A) of the Code and section 1.708-1(b)(2)(i) of the regulations is to provide for the continuation of one of the merging partnerships as the resulting partnership if the 50 percent test of those provisions is met, notwithstanding the provisions of the general rule of section 708(b)(1). Consistent with this purpose, a resulting (continuing) partnership in a merger to which section 708(b)(2)(A) applies is, as to the elements of the merger itself, excepted from the application of the termination provisions of section 708(b)(1).

Since section 761(e) of the Code cannot cause a termination of a partnership except through its effect on the term "exchange" in section 708(b)(1)(B), and since a resulting partnership in a merger to which section 708(b)(2)(A) applies is excepted from the application of section 708(b)(1) as to the elements of the merger itself, section 761(e) cannot cause the termination of the resulting partnership merely by virtue of its section 708(b)(2) merger.

Thus, the distribution of a total of 50 percent of the *RP* interests by *MP1* and *MP2* during the course of the merger will not cause a termination of *RP* under section 708(b)(1)(B) of the Code.

HOLDING

In a partnership merger, if the resulting partnership is considered a continuation of one of the merging partnerships under section 708(b)(2)(A) of the Code, liquidating distributions by the other merging partnerships of 50 percent or more of the capital and profits interest in the resulting partnership do not cause the resulting partnership to terminate under section 708(b)(1)(B).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 68-289 and Rev. Rul. 77-458 are clarified.

Part III.—Definitions

Section 761.—Terms Defined

If a partnership resulting from a partnership merger is considerd a continuation of one of the merging partnerships under section 708(b)(2)(A) of the Code, do liquidating distributions by the other merging partnerships of 50 percent or more of the capital and profits interests in the resulting partnership cause the resulting partnership to terminate under section 708(b)(1)(B) because of the application of section 761(e)? See Rev. Rul. 90-17, page 119.

Subchapter L.—Insurance Companies

Part I.—Life Insurance Companies

Subpart C.—Life Insurance Deductions

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1990. See Rev. Rul. 90-1, page 155.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth in the month of February 1990. See Rev. Rul. 90-12, page 156.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1990. See Rev. Rul. 90-22, page 158.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 1990. See Rev. Rul. 90-28, page 159.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1990. See Rev. Rul. 90-41, page 161.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 1990. See Rev. Rul. 90-48, page 162.

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26 CFR 1.807-1: Mortality and morbidity tables.

T.D. 8278

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Mortality and Morbidity Tables for Insurance Products For Which There Are No Applicable Commissioners' Standard Tables

AGENCY: Internal Revenue Service, Treasury

ACTION: Final regulations

SUMMARY: This document contains final regulations relating to mortality and morbidity tables for insurance products for which there are no applicable commissioners' standard tables. Changes to the applicable tax law were made by the Tax Reform Act of 1984. The regulations affect insurance companies engaged in the business of issuing life insurance, annuity, or noncancellable accident and health insurance contracts, and provide them with guidance needed to determine the amount of the life insurance reserves with respect to such contracts.

EFFECTIVE DATE: The regulations are effective for taxable years beginning after December 31, 1983, except section 1.807-1(a), items 10b and 13b, which are effective on December 26, 1989.

SUPPLEMENTARY INFORMATION:

Background

The document amends the Income Tax Regulations (26 CFR Part 1) to provide rules under section 807(d) of the Internal Revenue Code of 1986. Section 807(d), relating to the method of computing life insurance reserves, was added to the Code by section 211(a) of the Tax Reform Act of 1984 (Pub. L. 98-369) [1984-3 C.B. (Vol. 1) 1, 235]. On January 2, 1987, the Federal Register published temporary regulations (T.D. 8120, 52 FR 39) [1987-1 C.B. 167] relating to mortality and morbidity tables for insurance contracts for which there are no applicable commissioners' standard tables when the contracts are issued. The text of those temporary regulations also served as the comment document for a notice of proposed rulemaking ("the proposed regulations") [LR 71-86, 1987-1 C.B. 803]. Written comments were received from the public on the proposed regulations, but no public hearing was requested or held. After consideration of all comments received, the proposed amendments are adopted as revised by this regulation.

Effective Date of Changes

It is desirable to make the more up-to-date tables prescribed in the document immediately available to affected insurance companies. It is therefore found impracticable and contrary to the public interest to issue this Treasury decision subject to date limitations of section 553(d) of Title 5, United States Code.

Explanation of Provisions

Section 807(d)(2) provides in part that the amount of the life insurance reserve for any contract must be determined using the prevailing commissioners' standard tables for mortality and morbidity. If there are no commissioners' standard tables applicable to a contract when it is issued, section 807(d)(5)(C) provides that the mortality and morbidity tables to be used to compute the reserves will be determined under regulations. These regulations, therefore, specify mortality and morbidity tables for insurance contracts for which there are no commissioners' standard tables applicable when the contract is issued.

In addition, this document deletes existing regulations sections 1.807-1 and 1.807-2 because they are applicable only to taxable years beginning after December 31, 1953, and before January 1, 1955.

Public Comments

One comment on the proposed regulations suggested replacing the 1964 Commissioners' Disability Table (1964 CDT) for noncancellable accident and health disability benefit reserves with the 1985 Commissioners' Individual Disability Tables A and the 1985 Commissioners' Individual Disability Tables B (1985 CIDA/CIDB). The 1964 CDT is based on experience of 1930 through 1961 and does not differentiate by some factors which are generally recognized as affecting claim costs (e.g., occupation class, sex and elimination period). The 1985 CIDA/CIDB tables are based on experience of 1970 through 1979. The factors affecting claim costs are contained in the 1985 CIDA/CIDB tables. In addition, the 1985 CIDA/CIDB tables were adopted by the National Association of Insurance Commissioners (NAIC) in December of 1985 as the reserve standards for individual disability policies. The comment did not recommend any change in the tables

applicable to group disability policies. The final regulations adopt the use of the 1985 CIDA/CIDB tables for individual disability policies.

The NAIC *Proceedings*, 1986, Vol. I., page 592, indicates that the 1985 CIDA tables (previously known as the "DST Valuation Tables") may have a wider application because reserves can be distinguished by many more parameters than those using the 1985 CIDB tables (previously known as the "1983c Tables"). However, the CIDB tables may be easier to use by smaller and medium sized insurers where detailed breakdowns of disability business may not be practical.

As a consequence of adopting the use of the 1985 CIDA/CIDB tables, the regulations are further amended by adding a provision to reflect section 807(d)(5)(E) of the Code, which requires that if a taxpayer may use 2 or more tables (or options), then the table (or option) which generally yields the lowest reserves shall be used to compute reserves under section 807(d)(2) for the contract.

Another comment requested clarification of the table to be used for group life insurance disability income benefit contracts. The title of the contract described in item 4 of the list of tables in the proposed regulations would be changed from "Group life insurance (active life reserves); disability income benefits" to "Group life insurance disability income benefits." In addition, separate tables would be prescribed for active life reserves and for disabled life reserves. It was requested that (1) the tables of period 2 disablement rates and the 1930-1950 termination rates of the 1952 Disability Study of the Society of Actuaries be used for the active life reserves and (2) the 1930 to 1950 termination rates of the 1952 Disability Study of the Society of Actuaries be used for the disabled life reserves. The separate identification of tables would merely clarify the portions of the tables which are applicable to active and disabled lives, respectively. The final regulations adopt this change.

Special Analyses

It has been determined that these rule are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required.

* * * * *

Adoption of Amendments to the Regulations

For the reasons set out in the preamble, Chapter I Subchapter A, Part I of Title 26 of the Code of Federal Regulations is amended as follows:

INCOME TAX REGULATIONS (26 CFR Part 1)

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. *** Section 1.807-1 is also issued under 26 U.S.C. 807(d)(5)(C).

Par. 2. Sections 1.807-1T and 1.807-2 are removed.

Par. 3. Section 1.807-1 is revised to read as follows:

§1.807-1 Mortality and Morbidity Tables.

(a) *Tables to be used.* If there are no commissioners' standard tables applicable to an insurance contract when the contract is issued, then the mortality and morbidity table set forth in this subsection are used to compute reserves under section 807(d)(2) for the contract.

Type of Contract	Table
1. Group term life insurance (active life reserves).	1960 Commissioners' Standard Group Mortality Table.
2. Group life insurance (active life reserves); accidental death benefits.	1959 Accidental Death Benefits Table.
3. Permanent and paid-up group life insurance (active life reserves).	Same table as are applicable to males for ordinary life insurance.
4a. Group life insurance disability income benefits (active life reserves).	The tables of period 2 disablement rates and the 1930 to 1950 termination rates of the 1952 Disability Study of the Society of Actuaries.
4b. Group life insurance disability income benefits (disabled life reserves).	The 1930 to 1950 termination rates of the 1952 Disability Study of the Society of Actuaries.
5. Group life insurance; survivor income benefits insurance.	Same tables as are applicable to group annuities.
6. Group life insurance; extended death benefits for disabled lives.	1970 Intercompany Group Life Disability Valuation Table.
7. Credit life insurance.	1958 Commissioners' Extended Term Table.
8. Supplementary contracts involving life contingencies.	Same tables as are applicable to individual immediate annuities.
9. Noncancellable accident and health insurance (active life reserves); benefits issued before 1984.	Tables used for NAIC annual statement reserves as of December 31, 1983.
10a. Noncancellable accident and health insurance (active life reserves); group disability benefits issued after 1983 and individual disability benefits issued after 1983 and before 1989.	1964 Commissioners' Disability Tables.
10b. Noncancellable accident and health insurance (active life reserves); individual disability benefits issued after 1988.	1985 Commissioners' Individual Disability Table A or Commissioners' Individual Disability Table B..

Type of Contract	Table
11. Noncancellable accident and health insurance (active life reserves); accidental death benefits issued after 1983.	1959 Accidental Death Benefits Tables.
12. Noncancellable accident and health insurance (active life reserves); all benefits issued after 1983 other than disability and accidental death.	Tables used for NAIC annual statement reserves.
13a. Noncancellable accident and health insurance (claim reserves); group disability benefits for all years of issue and individual disability benefits for years before 1989.	1964 Commissioners' Disability Tables.
13b. Noncancellable accident and health insurance (claim reserves); individual disability benefits for years after 1988.	1985 Commissioners' Individual Disability Table A or Commissioners' Individual Disability Table B.
14. Noncancellable accident and health insurance (claim reserves); all benefits other than disability for all years of issue.	Tables used for annual statement reserves.

(b) *Adjustments.* An appropriate adjustment may be made to the tables in paragraph (a) of this section to reflect risks (such as substandard risks) incurred under the contract which are not otherwise taken into account.

(c) *Special rule where more than 1 table or option applicable.* If, with respect to any category of risks, there are 2 or more tables (options under 1 or more tables) in paragraph (a) of this section, the table (and option thereunder) which generally yields the lowest reserves shall be used to compute reserves under section 807(d)(2) for the contract.

(d) *Effective date.* This section is effective for taxable years beginning after December 31, 1983, except that the 1985 Commissioners' Individual Disability Tables A and B shall be treated (for purposes of section 807(d)(5)(B) and for purposes of determining the issue dates of contracts for which they shall be used) as if the tables were new prevailing commissioners' standard tables adopted by the twenty-sixth State on December 26, 1989.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved December 15, 1989.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 22, 1989, 8:45 a.m., and published in the issue of the Federal Register for December 26, 1989, 54 F.R. 52933)

Part II.—Other Insurance Companies

Section 832.—Insurance Company Taxable Income

26 CFR 1.832-4T: Gross income (temporary).

T.D. 8293

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Treatment of Salvage and Reinsurance Under Section 832(b)

AGENCY: Internal Revenue Service, Treasury

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the treatment of salvage and reinsurance under section 832(b)(5) of the Internal Revenue Code. The regulations affect property and casualty insurance companies, and are necessary to provide them with guidance in computing the losses incurred deduction of that section. The text of the temporary regulations set forth in this document also serves as the text of the proposed regulations for the notice of proposed rulemaking on this subject in *** [FI-76-89, page 632, this Bulletin].

EFFECTIVE DATES: Section 1.832-7T is effective for taxable years beginning before January 1, 1990. The amendments to §1.832-4T are effective for taxable years beginning after December 31, 1989.

SUPPLEMENTARY INFORMATION:

Background

This document amends the Income Tax Regulations (26 CFR Part 1) to provide temporary rules relating to the treatment of salvage and reinsurance under section 832(b)(5) of the Internal Revenue Code.

Explanation of Provisions

The losses incurred deduction described in section 832(b)(5) includes both losses paid and unpaid losses. Section 832(b)(5) requires that the losses paid component of the deduction be reduced by any increases in salvage and reinsurance recoverable.

The regulations under section 832 were amended by the Internal Revenue Service on January 5, 1988, to require that salvage recoverable be taken into account in the computation of both losses paid and unpaid losses. Although section 832(b)(5) requires this treatment with respect to losses paid, the prior regulations allowed taxpayers to exclude any salvage not permitted to be taken into account for state insurance regulatory purposes. This regulations were amended to delete this exclusion and thereby produce a clearer reflection of income.

The regulations also were amended in 1988 to clarify that a reasonable estimate of the amount of unpaid losses that a taxpayer will be required to pay must take into account expected recoveries on account of salvage and reinsurance attributable to such losses. In addition, the 1988 amend-

ments provided guidance on accounting adjustments to be made by taxpayers not already in compliance with the amended regulations, and clarified that the term "salvage" includes subrogation claims.

On September 22, 1989, the Internal Revenue Service issued temporary regulations postponing the effective date of the 1988 amendments until taxable years beginning after December 31, 1988, and reinstating the prior regulations for taxable years beginning before January 1, 1989.

The temporary regulations published in this treasury decision further postpone the effective date of the 1988 amendments until taxable years beginning after December 31, 1989, and continue the application of the prior regulations for taxable years beginning before January 1, 1990. For taxable years beginning before January 1, 1990, a taxpayer complying with the provisions of section 1.832-4T is deemed to have used a proper method of accounting for salvage.

Special analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Amendments to the regulations

For the reasons set out in the preamble, Part 1 of Title 26 of the Code of Federal Regulations is amended as set forth below:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. The authority for Part 1 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 2. Section 1.832-4T is amended by revising paragraphs (d)(1) and (e) to read as follows:

§1.832-4T Gross income (temporary).

* * * * *

(d)(1) The treatment of salvage and reinsurance is a method of accounting. Every insurance company to which this section applies that did not treat salvage and reinsurance as provided in this section for the last taxable year beginning before January 1, 1990, must change its method of accounting with respect to salvage and reinsurance in the first taxable year beginning after December 31, 1989. The change in method of accounting will result in a section 481(a) adjustment. The fresh start provision of section 1023(e) of the Tax Reform Act of 1986 does not apply to the change in method of accounting required by this paragraph (d)(1).

* * * * *

(e) Paragraphs (b), (c), and (d) of this section are effective for taxable years beginning after December 31, 1989. Taxpayers complying with the provisions of this section for taxable years beginning before January 1, 1990, are deemed to have used a proper method of accounting for salvage for such taxable years. In computing unpaid losses for taxable years beginning before January 1, 1990, an insurance company to which this section applies is not required to take into account estimated recoveries on account of salvage attributable to unpaid losses. In addition, the provisions of §1.832-7T apply to the treatment of salvage recoverable in the computation of paid losses for such taxable years.

Par. 3. Section 1.832-7T is amended by revising the caption and paragraph (d) to read as follows:

§1.832-7T Treatment of salvage and reinsurance in computing "losses incurred" deduction, taxable years beginning before January 1, 1990 (temporary).

* * * * *

(d) This section is effective for taxable years beginning before January 1, 1990.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason it is impracticable to issue this Treasury decision with notice and public procedure under section (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved February 28, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 13, 1990, 8:45 a.m., and published in the issue of the Federal Register for March 14, 1990, 55 F.R. 9424)

Part III.—Provisions of General Application

Section 846.—Discounted Unpaid Losses Defined

Insurance companies; loss reserves; discounting unpaid losses. The loss payment patterns and discount factors are set forth for calendar year 1990 for each property and casualty business to be used in discounting the deduction for loss reserves for purposes of section 846 of the Code.

Rev. Rul. 90-26

For purposes of section 846 of the Internal Revenue Code, the following are the loss payment patterns and discount factors for calendar year 1990 for each property and casualty line of business to be used in discounting the deduction for loss reserves. Section 846 requires all property and casualty loss reserves (unpaid losses and unpaid loss adjustment expenses) for each line of business (as shown on the annual statement approved by the National Association of Insurance Commissioners (NAIC)) to be discounted for federal income tax purposes. The discount factors were determined by using an interest rate for 1990 of 8.37 percent, the interest rate determined under section 846(c).

COMPOSITE SCHEDULE P

Years before current year	Year loss incurred	Loss & loss expense payments to date (000s)	Total losses and loss expense incurred (000s)	Cumulative fraction of loss paid (percent)	Fraction of loss paid during year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	27050900	78832067	34.3146	34.3146	65.6854	54.2288	82.5584
AY + 1	1984	42762165	70059326	61.0371	26.7225	38.9629	30.9494	79.4331
AY + 2	1983	46304723	62932278	73.5787	12.5416	26.4213	20.4840	77.5283
AY + 3	1982	46339283	56724398	81.6920	8.1133	18.3080	13.7525	75.1173
AY + 4	1981	44014354	50826873	86.5966	4.9046	13.4034	9.7978	73.0994
AY + 5	1980	41790830	46281924	90.2962	3.6996	9.7038	6.7665	69.7311
AY + 6	1979	38531049	41768331	92.2494	1.9532	7.7506	5.2996	68.3769
AY + 7	1978	33285121	35572301	93.5703	1.3209	6.4297	4.3681	67.9368
AY + 8	1977	29524057	31225532	94.5510	0.9807	5.4490	3.7128	68.1378
AY + 9	1976	26745914	28167858	94.9519	0.4009	5.0481	3.6063	71.4380
AY + 10	Pre 1976	184257188	188825255	NA	0.4009	4.6472	3.4908	75.1156
AY + 11	NA	NA	NA	NA	0.4009	4.2464	3.3657	79.2599
AY + 12	NA	NA	NA	NA	0.4009	3.8455	3.2300	83.9959
AY + 13	NA	NA	NA	NA	0.4009	3.4446	3.0831	89.5048
AY + 14	NA	NA	NA	NA	0.4009	3.0437	2.9238	96.0606
AY + 15	NA	NA	NA	NA	3.0437	0.0000	0.0000	96.0606

AUTOMOBILE LIABILITY

Years before current year	Year loss incurred	Loss & loss expense payments to date (000s)	Total losses and loss expense incurred (000s)	Cumulative fraction of loss paid (percent)	Fraction of loss paid during year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	10734519	31281287	34.3161	34.3161	65.6839	57.6062	87.7021
AY + 1	1984	18397279	28217053	65.1992	30.8830	34.8008	30.2783	87.0044
AY + 2	1983	20047428	24986353	80.2335	15.0344	19.7665	17.1616	86.8219
AY + 3	1982	19808529	22243403	89.0535	8.8200	10.9465	9.4164	86.0219
AY + 4	1981	18974882	20225872	93.8149	4.7614	6.1851	5.2479	84.8471
AY + 5	1980	17105852	17717213	96.5493	2.7344	3.4507	2.8405	82.3190
AY + 6	1979	16266022	16633374	97.7915	1.2421	2.2085	1.7852	80.8335
AY + 7	1978	14534843	14766868	98.4287	0.6373	1.5713	1.2712	80.9065
AY + 8	1977	12853464	13027563	98.6636	0.2349	1.3364	1.1332	84.7922
AY + 9	1976	11389407	11506437	98.9829	0.3193	1.0171	0.8956	88.0555
AY + 10	Pre 1976	91306371	91545592	NA	0.3193	0.6978	0.6382	91.4560
AY + 11	NA	NA	NA	NA	0.3193	0.3785	0.3592	94.9008
AY + 12	NA	NA	NA	NA	0.3193	0.0592	0.0568	96.0606
AY + 13	NA	NA	NA	NA	0.0592	0.0000	0.0000	96.0606

OTHER LIABILITY

Years before current year	Year loss incurred	Loss & loss expense payments to date (000s)	Total losses and loss expense incurred (000s)	Cumulative fraction of loss paid (percent)	Fraction of loss paid during year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	824218	8957695	9.2012	9.2012	90.7988	67.2552	74.0706
AY + 1	1984	1752555	6901148	25.3951	16.1939	74.6049	56.0265	75.0977
AY + 2	1983	2493908	6222045	40.0818	14.6867	59.9182	45.4270	75.8150
AY + 3	1982	3181315	5762517	55.2070	15.1252	44.7930	33.4837	74.7521
AY + 4	1981	3429366	5180556	66.1969	10.9898	33.8031	24.8458	73.5014
AY + 5	1980	3548964	4724863	75.1125	8.9157	24.8875	17.6441	70.8954
AY + 6	1979	3339115	4162493	80.2191	5.1066	19.7809	13.8049	69.7890
AY + 7	1978	3050437	3610079	84.4978	4.2787	15.5022	10.5062	67.7723
AY + 8	1977	2812829	3245716	86.6628	2.1650	13.3372	9.1318	68.4684

Years before current year	Year loss incurred	Loss & loss expense payments to date (000s)	Total losses and loss expense incurred (000s)	Cumulative fraction of loss paid (percent)	Fraction of loss paid during year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 9	1976	2702169	3081827	87.6807	1.0179	12.3193	8.8364	71.7285
AY + 10	Pre 1976	23480898	25101360	NA	1.0179	11.3013	8.5163	75.3570
AY + 11	NA	NA	NA	NA	1.0179	10.2834	8.1695	79.4435
AY + 12	NA	NA	NA	NA	1.0179	9.2655	7.7936	84.1145
AY + 13	NA	NA	NA	NA	1.0179	8.2475	7.3862	89.5571
AY + 14	NA	NA	NA	NA	1.0179	7.2296	6.9448	96.0606
AY + 15	NA	NA	NA	NA	7.2296	0.0000	0.0000	96.0606

WORKERS' COMPENSATION

Years before current year	Year loss incurred	Loss & loss expense payments to date (000s)	Total losses and loss expense incurred (000s)	Cumulative fraction of loss paid (percent)	Fraction of loss paid during year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	3932938	15174769	25.9176	25.9176	74.0824	58.4232	78.8625
AY + 1	1984	7635807	14004437	54.5242	28.6066	45.4758	33.5336	73.7393
AY + 2	1983	8124465	11973169	67.8556	13.3314	32.1444	22.4622	69.8790
AY + 3	1982	8126215	10749254	75.5979	7.7423	24.4021	16.2824	66.7257
AY + 4	1981	8203632	10245226	80.0727	4.4748	19.9273	12.9870	65.1719
AY + 5	1980	7893190	9444281	83.5764	3.5037	16.4236	10.4266	63.4857
AY + 6	1979	7559441	8845526	85.4606	1.8842	14.5394	9.3379	64.2246
AY + 7	1978	6621807	7594942	87.1871	1.7264	12.8129	8.3222	64.9515
AY + 8	1977	5981586	6744498	88.6884	1.5013	11.3116	7.4559	65.9134
AY + 9	1976	5510811	6170361	89.3110	0.6226	10.6890	7.4318	69.5274
AY + 10	Pre 1976	46351166	48577936	NA	0.6226	10.0664	7.4057	73.5684
AY + 11	NA	NA	NA	NA	0.6226	9.4438	7.3774	78.1190
AY + 12	NA	NA	NA	NA	0.6226	8.8211	7.3467	83.2852
AY + 13	NA	NA	NA	NA	0.6226	8.1985	7.3135	89.2048
AY + 14	NA	NA	NA	NA	0.6226	7.5759	7.2775	96.0606
AY + 15	NA	NA	NA	NA	7.5759	0.0000	0.0000	96.0606

MEDICAL MALPRACTICE

Years before current year	Year loss incurred	Loss & loss expense payments to date (000s)	Total losses and loss expense incurred (000s)	Cumulative fraction of loss paid (percent)	Fraction of loss paid during year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	85689	2835465	3.0220	3.0220	96.9780	63.5019	65.4807
AY + 1	1984	312207	2404595	12.9838	9.9617	87.0162	58.4467	67.1676
AY + 2	1983	534322	2280478	23.4303	10.4465	76.5697	52.4638	68.5177
AY + 3	1982	745691	2095689	35.5821	12.1519	64.4179	44.2048	68.6220
AY + 4	1981	836834	1839826	45.4844	9.9023	54.5156	37.5964	68.9645
AY + 5	1980	846392	1574497	53.7563	8.2719	46.2437	32.1321	69.4843
AY + 6	1979	800223	1316417	60.7880	7.0316	39.2120	27.5016	70.1355
AY + 7	1978	745973	1109154	67.2560	6.4681	32.7440	23.0701	70.4561
AY + 8	1977	639578	883594	72.3837	5.1277	27.6163	19.6631	71.2012
AY + 9	1976	627818	835753	75.1200	2.7363	24.8800	18.4604	74.1978
AY + 10	Pre 1976	1959501	2323449	NA	2.7363	22.1436	17.1570	77.4804
AY + 11	NA	NA	NA	NA	2.7363	19.4073	15.7444	81.1265
AY + 12	NA	NA	NA	NA	2.7363	16.6709	14.2137	85.2604
AY + 13	NA	NA	NA	NA	2.7363	13.9346	12.5548	90.0983
AY + 14	NA	NA	NA	NA	2.7363	11.1982	10.7571	96.0606
AY + 15	NA	NA	NA	NA	11.1982	0.0000	0.0000	96.0606

FARMOWNERS MULTIPLE PERIL, HOMEOWNERS MULTIPLE PERIL, COMMERCIAL MULTIPLE PERIL, OCEAN MARINE, AIRCRAFT (ALL PERILS) AND BOILER AND MACHINERY

Years before current year	Year loss incurred	Loss & loss expense payments to date (000s)	Total losses and loss expense incurred (000s)	Cumulative fraction of loss paid (percent)	Fraction of loss paid during year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	11473534	20582849	55.7432	55.7432	44.2568	38.6581	87.3496
AY + 1	1984	14664316	18532075	79.1294	23.3862	20.8706	17.5486	84.0827
AY + 2	1983	15104598	17470233	86.4591	7.3297	13.5409	11.3871	84.0941
AY + 3	1982	14477532	15873533	91.2055	4.7464	8.7945	7.3992	84.1339
AY + 4	1981	12569638	13335391	94.2577	3.0523	5.7423	4.8411	84.3056
AY + 5	1980	12396429	12821063	96.6880	2.4303	3.3120	2.7163	82.0146
AY + 6	1979	10566246	10810520	97.7404	1.0524	2.2596	1.8481	81.7897
AY + 7	1978	8332059	8491257	98.1252	0.3847	1.8748	1.6023	85.4617
AY + 8	1977	7236609	7324158	98.8047	0.6795	1.1953	1.0290	86.0856
AY + 9	1976	6515706	6573477	99.1212	0.3165	0.8788	0.7857	89.3980
AY + 10	Pre 1976	21159251	21276916	NA	0.3165	0.5624	0.5220	92.8170
AY + 11	NA	NA	NA	NA	0.3165	0.2459	0.2362	96.0606
AY + 12	NA	NA	NA	NA	0.2459	0.0000	0.0000	96.0606

FIRE

Years before current year	Year loss incurred	Net losses paid in year (000s)	Unpaid losses beginning of year (000s)	Fraction of unpaid loss paid in year (percent)	Fraction of total loss paid in year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	1182445	2142829	55.1815	55.1815	44.8185	41.7295	93.1078
AY + 1	1984	687222	944426	72.7661	32.6127	12.2058	11.2722	92.3510
AY + 2	Pre 1984	196764	462600	NA	6.1029	6.1029	5.8625	96.0606
AY + 3	NA	NA	NA	NA	6.1029	0.0000	0.0000	96.0606

ALLIED LINES

Years before current year	Year loss incurred	Net losses paid in year (000s)	Unpaid losses beginning of year (000)s	Fraction of unpaid loss paid in year (percent)	Fraction of total loss paid in year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	657907	1076282	61.1278	61.1278	38.8722	36.3527	93.5185
AY + 1	1984	297197	388220	76.5538	29.7582	9.1141	8.4169	92.3510
AY + 2	Pre 1984	77676	174175	NA	4.5570	4.5570	4.3775	96.0606
AY + 3	NA	NA	NA	NA	4.5570	0.0000	0.0000	96.0606

INLAND MARINE

Years before current year	Year loss incurred	Net losses paid in year (000s)	Unpaid losses beginning of year (000s)	Fraction of unpaid loss paid in year (percent)	Fraction of total loss paid in year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	1101567	1913177	57.5779	57.5779	42.4221	39.6873	93.5533
AY + 1	1984	562321	731477	76.8747	32.6119	9.8102	9.0598	92.3510
AY + 2	Pre 1984	140515	321225	NA	4.9051	4.9051	4.7119	96.0606
AY + 3	NA	NA	NA	NA	4.9051	0.0000	0.0000	96.0606

MISCELLANEOUS CASUALTY

Years before current year	Year loss incurred	Net losses paid in year (000s)	Unpaid losses beginning of year (000s)	Fraction of unpaid loss paid in year (percent)	Fraction of total loss paid in year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	185443	216664	85.5901	85.5901	14.4099	13.6025	94.3972
AY + 1	1984	12581	14861	84.6578	12.1991	2.2108	2.0417	92.3510
AY + 2	Pre 1984	1729	4100	NA	1.1054	1.1054	1.0618	96.0606
AY + 3	NA	NA	NA	NA	1.1054	0.0000	0.0000	96.0606

EARTHQUAKE

Years before current year	Year loss incurred	Net losses paid in year (000s)	Unpaid losses beginning of year (000s)	Fraction of unpaid loss paid in year (percent)	Fraction of total loss paid in year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	3852	13974	27.5655	27.5655	72.4345	66.0430	91.1762
AY + 1	1984	1654	3010	54.9502	39.8029	32.6316	30.1356	92.3510
AY + 2	Pre 1984	722	1757	NA	16.3158	16.3158	15.6731	96.0606
AY + 3	NA	NA	NA	NA	16.3158	0.0000	0.0000	96.0606

AUTO PHYSICAL DAMAGE

Years before current year	Year loss incurred	Net losses paid in year (000s)	Unpaid losses beginning of year (000s)	Fraction of unpaid loss paid in year (percent)	Fraction of total loss paid in year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	13876758	16695051	83.1190	83.1190	16.8810	16.0968	95.3546
AY + 1	1984	1743502	1864945	93.4881	15.7817	1.0993	1.0152	92.3510
AY + 2	Pre 1984	-128871	-44115	NA	0.5496	0.5496	0.5280	96.0606
AY + 3	NA	NA	NA	NA	0.5496	0.0000	0.0000	96.0606

FIDELITY

Years before current year	Year loss incurred	Net losses paid in year (000s)	Unpaid losses beginning of year (000s)	Fraction of unpaid loss paid in year (percent)	Fraction of total loss paid in year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	63993	281102	22.7650	22.7650	77.2350	70.0945	90.7549
AY + 1	1984	108652	212771	51.0652	39.4402	37.7947	34.9038	92.3510
AY + 2	Pre 1984	76630	196869	NA	18.8974	18.8974	18.1529	96.0606
AY + 3	NA	NA	NA	NA	18.8974	0.0000	0.0000	96.0606

SURETY

Years before current year	Year loss incurred	Net losses paid in year (000s)	Unpaid losses beginning of year (000s)	Fraction of unpaid loss paid in year (percent)	Fraction of total loss paid in year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	322557	869869	37.0811	37.0811	62.9189	57.2344	90.9654
AY + 1	1984	221719	418289	53.0062	33.3509	29.5680	27.3063	92.3510
AY + 2	Pre 1984	29380	252418	NA	14.7840	14.7840	14.2016	96.0606
AY + 3	NA	NA	NA	NA	14.7840	0.0000	0.0000	96.0606

GLASS

Years before current year	Year loss incurred	Net losses paid in year (000s)	Unpaid losses beginning of year (000s)	Fraction of unpaid loss paid in year (percent)	Fraction of total loss paid in year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	5330	8021	66.4506	66.4506	33.5494	31.7557	94.6536
AY + 1	1984	1482	1703	87.0229	29.1957	4.3537	4.0207	92.3510
AY + 2	Pre 1984	145	518	NA	2.1769	2.1769	2.0911	96.0606
AY + 3	NA	NA	NA	NA	2.1769	0.0000	0.0000	96.0606

BURGLARY AND THEFT

Years before current year	Year loss incurred	Net losses paid in year (000s)	Unpaid losses beginning of year (000s)	Fraction of unpaid loss paid in year (percent)	Fraction of total loss paid in year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	16947	35142	48.2243	48.2243	51.7757	48.5715	93.8114
AY + 1	1984	10304	13001	79.2554	41.0350	10.7406	9.9191	92.3510
AY + 2	Pre 1984	3182	8093	NA	5.3703	5.3703	5.1588	96.0606
AY + 3	NA	NA	NA	NA	5.3703	0.0000	0.0000	96.0606

CREDIT

Years before current year	Year loss incurred	Net losses paid in year (000s)	Unpaid losses beginning of year (000s)	Fraction of unpaid loss paid in year (percent)	Fraction of total loss paid in year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	54286	218630	24.8301	24.8301	75.1699	67.4286	89.7015
AY + 1	1984	52253	126369	41.3495	31.0824	44.0875	40.7153	92.3510
AY + 2	Pre 1984	9995	43661	NA	22.0438	22.0438	21.1754	96.0606
AY + 3	NA	NA	NA	NA	22.0438	0.0000	0.0000	96.0606

CREDIT ACCIDENT and HEALTH (Group and Individual)

Years before current year	Year loss incurred	Net losses paid in year (000s)	Unpaid losses beginning of year (000s)	Fraction of unpaid loss paid in year (percent)	Fraction of total loss paid in year (percent)	Fraction of loss unpaid, year-end (percent)	Discounted fraction unpaid, year-end (percent)	Reserve discount factor (percent)
AY + 0	1985	50544	93229	54.2149	54.2149	45.7851	42.1277	92.0118
AY + 1	1984	26637	42512	62.6576	28.6879	17.0973	15.7895	92.3510
AY + 2	Pre 1984	8295	18171	NA	8.5486	8.5486	8.2119	96.0606
AY + 3	NA	NA	NA	NA	8.5486	0.0000	0.0000	96.0606

Guidance is provided concerning the manner in which taxpayers are to apply discount factors under section 846 of the Code to unpaid losses as reported in the new configuration of lines of business that was adopted for the 1989 annual statement for fire and casualty insurance companies. See Rev. Proc. 90-23, page 507.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1990. See Rev. Rul. 90-1, page 155.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1990. See Rev. Rul. 90-12, page 156.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1990. See Rev. Rul. 90-22, page 158.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 1990. See Rev. Rul. 90-28, page 159.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1990. See Rev. Rul. 90-41, page 161.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 1990. See Rev. Rul. 90-48, page 162.

Subchapter M.—Regulated Investment Companies and Real Estate Investment Trusts

Part I. Regulated Investment Companies

Section 852.—Taxation of Regulated Investment Companies and Their Shareholders

26 CFR 1.852-11T: Treatment of certain losses attributable to periods after October 31 of a taxable year (temporary).

T.D. 8287

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Treatment of Certain Losses Attributable to Periods After October 31 of a Taxable Year of a Regulated Investment Company

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations relating to the treatment by a regulated investment company of a net capital loss, a net long-term capital loss, or a net foreign currency loss attributable to periods after October 31 of a taxable year. The applicable tax law was amended by the Tax Reform Act of 1986 and by the Technical and Miscellaneous Revenue Act of 1988. These regulations provide guidance to regulated investment companies as to the proper manner of determining taxable income, earnings and profits, and the amount that may be designated as capital gain dividends for a taxable year. The text of the temporary regulations set forth in this document also serves as the text of the cross-reference notice of proposed rulemaking published in *** [FI-105-88, page 630, this Bulletin].

EFFECTIVE DATE: These regulations are effective for taxable years of regulated investment companies ending after October 31, 1987.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in these regulations have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under control number 1545-1094. The estimated average annual burden associated with the collections of information in these regulations is fifteen minutes per respondent.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents may require greater or less time, depending on their particular circumstances.

For further information concerning these collections of information, and where to submit comments on these collections of information, the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-reference notice of proposed rulemaking published in *** [FI-105-88, page 630, this Bulletin].

Background

This document amends the Income Tax Regulations (26 CFR Part 1) under section 852 of the Internal Revenue Code of 1986 to reflect certain amendments made to the Code by the Tax Reform Act of 1986 (Pub. L. 99-514; 100 Stat. 2085) ("1986 Act") [1986-3 C.B. (Vol. 1) 1] and by the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. 100-647; 102 Stat. 3342) ("TAMRA"). These amendments to the regulations reflect the addition of section 852(b)(8) to the Code and the amendments made to sections 852(b)(3)(C) and 852(c) of the Code by sections 651(b)(2) and (3) of the 1986 Act and sections 1006(l)(3), (4), and (7) of TAMRA.

These recent additions and amendments to the Code are designed to improve the coordination between the income tax provisions applicable to RICs and the provisions of new section 4982, which imposes an excise tax on a RIC which fails to distribute a certain amount of its income. The principal difficulty in coordinating the provisions is that section 4982 generally requires a RIC to use a 12-month period ending on October 31 in measuring its capital gains and losses and foreign currency gains and losses for excise tax purposes regardless of the accounting period the RIC uses in computing its taxable income. The recent Code changes provide for adjustments to a RIC's taxable income to take into account the October 31 excise tax closing date. Section 4982(e)(4) permits a RIC using a taxable year ending November 30 or December 31 to elect to use its taxable year for purposes of the excise tax rather than the October 31 closing date. The special income tax adjustments therefore do not apply to a RIC making the section 4982(e)(4) election because the same period is used for both income tax and excise tax purposes.

Section 852(b)(3)(C) provides that, for purposes of determining the amount a RIC may designate as capital gain dividends for a taxable year to which an election under section 4982(e)(4) does not apply, the amount of the RIC's net capital gain shall be determined without regard to any net capital loss or net long-term capital loss attributable to the period after October 31 of the taxable year (the "post-October period"), and any such loss shall be treated as arising on the first day of the next taxable year (the "succeeding year"). Section 852(b)(3)(C) also provides that, to the extent set forth in regulations, these rules shall apply for purposes of determining a RIC's taxable income.

Section 852(b)(8) provides that, to the extent provided in regulations, the taxable income of a RIC for a taxable year to which an election under section 4982(e)(4) does not apply shall be computed without regard to any net foreign currency loss attributable to its post-October period, and any such loss shall be treated as arising on the first day of the succeeding year.

Section 852(c)(1) provides that any amount that is not allowable as a deduction in computing a RIC's taxable income for a taxable year does

not reduce the RIC's earnings and profits for that year (although such amount may reduce its accumulated earnings and profits). A RIC's earnings and profits for a taxable year are thus determined without regard to any net capital loss, net long-term capital loss, or net foreign currency loss not included in computing the RIC's taxable income for that taxable year. In addition, section 852(c)(2) provides that, with respect to certain distributions made in a calendar year, a RIC's earnings and profits are determined without regard to any net capital loss or net foreign currency loss after October 31 of that year, adjusted as provided by regulations.

Explanation of the regulations

The regulations provide guidance relating to the determination of the amount that may be designated as capital gain dividends and to the determination of earnings and profits by a RIC having a net capital loss, a net long-term capital loss, or a net foreign currency loss attributable to the post-October period of a taxable year.

In addition, the regulations provide procedures by which a RIC may elect to defer part or all of a net capital loss, a net long-term capital loss, or a net foreign currency loss attributable to its post-October period to the succeeding year for purposes of determining its taxable income. The regulations also provide guidance relating to the proper calculation of taxable income and earnings and profits for the years affected.

Section 1.852-11T(c) of the regulations defines the term "post-October capital loss" to mean any net capital loss attributable to sales or exchanges after October 31 of a taxable year or, if there is no such net capital loss, any net long-term capital loss attributable to that period. In addition, §1.852-11T(d)(1) defines the term "post-October currency loss" to mean any net foreign currency loss that is properly attributable to transactions after October 31 of a taxable year.

Section 1.852-11T(e) of the regulations provides that, for purposes of determining the amount a RIC may designate as capital gain dividends for a taxable year, any post-October capital loss for that year is disregarded. The post-October capital loss is treated as arising on the first day of the succeeding year.

Section 1.852-11T(f)(1) of the regulations provides that a RIC may elect to compute its taxable income for a taxable year without regard to part or all of its post-October capital loss or post-October currency loss for that year. Under §1.852-11T(f)(4), any part of a post-October capital or currency loss for a taxable year that a RIC elects to defer under §1.852-11T(f)(1) is treated as arising on the first day of the succeeding year. Thus, that part of any post-October capital or currency loss for a taxable year that a RIC elects to defer under §1.852-11T(f)(1) will be disregarded in computing the RIC's taxable income for that year, but will be taken into account in computing the RIC's taxable income for the succeeding year.

Under §1.852-11T(f)(5), an election to defer a post-October capital or currency loss under §1.852-11T(f)(1) for purposes of determining a RIC's taxable income will not affect the amount of the RIC's gross income for that taxable year (or the succeeding year) for purposes of sections 851(b)(2) or (3).

Section 1.852-11T(g)(1) of the regulations provides that a RIC's current earnings and profits for a taxable year are determined without regard to any post-October capital or currency loss for that year, but that a post-October capital or currency loss is generally taken into account in determining the RIC's accumulated earnings and profits. If a RIC elects to defer part or all of a post-October capital or currency loss for a taxable year for purposes of computing its taxable income, however, §1.852-11T(g)(2) provides that, for all taxable years, the amount of loss deferred is taken into account in determining the RIC's current earnings and profits and accumulated earnings and profits as if the part of the loss so deferred had arisen on the first day of the succeeding year.

Section 1.852-11T(g)(1) of the regulations also provides that, if with respect to a calendar year a RIC distributes amounts in excess of a limiting amount (the amount that would be the required distribution for the calendar year under section 4982 if "100 percent" were substituted for each percentage set forth in section 4982(b)(1)), then solely for purposes of characterizing those excess distributions the RIC's current earnings and profits are determined by taking into account any post-October capital loss or post-October currency loss.

Section 1.852-11T(i)(1) provides that, in general, a RIC may elect to defer part or all of its post-October capital or currency loss by completing its income tax return (including any necessary schedules) for that taxable year in accordance with the instructions applicable to the election. However, if the applicable form and related instructions for the taxable year do not reflect these temporary regulations, a RIC must make an election to defer a post-October capital or currency loss by attaching a written statement to the return in the manner prescribed by §1.852-11T(i)(2).

Section 1.852-11T(j) provides a special transitional rule which permits a RIC to make a retroactive election to defer a post-October capital or currency loss under certain circumstances by following the procedures provided in that section. In addition, §1.852-11T(j) permits a RIC to pay a retroactive dividend in an amount not in excess of the increase, if any, in the RIC's investment company taxable income or net capital gain that is attributable solely to the RIC's having made a retroactive election under this section. Section 1.852-11T(j) further provides that the deadline for making a retroactive election is December 31, 1990, and that a retroactive dividend must be declared on or before the date a retroactive election is made. A retroactive dividend must be paid (or treated as paid under section 852(b)(7)) on or before December 31, 1990.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is

not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Amendments to the regulations:

The amendments to Parts 1 and 602 of Title 26 of the Code of Federal Regulations are as follows:

PART 1—INCOME TAX; TAXABLE YEARS ENDING AFTER OCTOBER 31, 1987

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805 * * * Section 1.852-11T is also issued under 26 U.S.C. 852(b)(3)(C), 852(b)(8), and 852(c).

Par. 2. A new §1.852-11T is added to read as follows:

§1.852-11T Treatment of certain losses attributable to periods after October 31 of a taxable year (Temporary).

(a) *Outline of provisions.* This paragraph lists the provisions of this section.

(a) Outline of provisions.

(b) Scope.
(1) In general.
(2) Limitation on application of section.

(c) Post-October capital loss defined.

(d) Post-October currency loss defined.
(1) Post-October currency loss.
(2) Net foreign currency loss.
(3) Foreign currency gain or loss.

(e) Limitation on capital gain dividends.
(1) In general.
(2) Amount taken into account in current year.
(i) Net capital loss.
(ii) Net long-term capital loss.
(3) Amount taken into account in succeeding year.

(f) Regulated investment company may elect to defer certain losses for purposes of determining taxable income.
(1) In general.
(2) Effect of election in current year.
(3) Amount of loss taken into account in current year.
(i) If entire amount of net capital loss deferred.
(ii) If part of net capital loss deferred.
(A) In general.
(B) Character of capital loss not deferred.
(iii) If entire amount of net long-term capital loss deferred.
(iv) If part of net long-term capital loss deferred.
(v) If entire amount of post-October currency loss deferred.
(vi) If part of post-October currency loss deferred.
(4) Amount of loss taken into account in succeeding year.
(5) Effect on gross income.

(g) Earnings and profits.
(1) General rule.
(2) Special Rule—Treatment of losses that are deferred for purposes of determining taxable income.

(h) Examples.

(i) Procedure for making election.
(1) In general.
(2) When applicable instructions not available.

(j) Transition rules.
(1) In general.
(2) Retroactive election.
(i) In general.
(ii) Deadline for making election.
(3) Amended return required for succeeding year in certain circumstances.
(i) In general.
(ii) Time for filing amended return.
(4) Retroactive dividend.
(5) Deduction for dividends paid.
(i) In general.
(ii) Declaration and payment date.
(iii) Limitation on ordinary dividends.
(iv) Limitation on capital gain dividends.
(v) Effect on other years.
(vi) Example.

(k) Effective date.

(b) *Scope*—(1) *In general.* This section prescribes the manner in which a regulated investment company must treat a post-October capital loss (as defined in paragraph (c) of this section) or a post-October currency loss (as defined in paragraph (d)(1) of this section) for purposes of determining its taxable income, its earnings and profits, and the amount that it may designate as capital gain dividends for the taxable year in which the loss is incurred and the succeeding taxable year (the "succeeding year").

(2) *Limitation on application of section.* This section shall not apply to any post-October capital loss or post-October currency loss of a regulated investment company attributable to a taxable year for which an election is in effect under section 4982(e)(4) of the Code with respect to the company.

(c) *Post-October capital loss defined.* For purposes of this section, the term "post-October capital loss" means—

(1) Any net capital loss attributable to sales or exchanges after October 31 of a taxable year; or

(2) If there is no such net capital loss, any net long-term capital loss attributable to sales or exchanges after October 31 of a taxable year.

The amount of any net capital loss or any net long-term capital loss attributable to sales or exchanges after October 31 of a taxable year shall be determined in accordance with general tax law principles by treating the period beginning on November 1 of the taxable year of the regulated investment company and ending on the last day of such taxable year as though it were the taxable year of the regulated investment company.

(d) *Post-October currency loss defined.* For purposes of this section—

(1) *Post-October currency loss.* The term "post-October currency loss" means any net foreign currency loss attributable to section 988 transactions that are properly attributable to the portion of the regulated investment company's taxable year after October 31.

(2) *Net foreign currency loss.* The term "net foreign currency loss" means the excess of foreign currency losses over foreign currency gains.

(3) *Foreign currency gain or loss.* The terms "foreign currency gain" and "foreign currency loss" have the

same meaning as provided in section 988(b).

(e) *Limitation on capital gain dividends*—(1) *In general.* For purposes of determining the amount a regulated investment company may designate as capital gain dividends for a taxable year, the amount of net capital gain for the taxable year shall be determined without regard to any post-October capital loss for such year.

(2) *Amount taken into account in current year*—(i) *Net capital loss.* If the post-October capital loss referred to in paragraph (e)(1) of this section is a post-October capital loss as defined in paragraph (c)(1) of this section, the net capital gain of the company for the taxable year in which the loss arose shall be determined without regard to any capital gains or losses (both long-term and short-term) from sales or exchanges after October 31 of the taxable year.

(ii) *Net long-term capital loss.* If the post-October capital loss referred to in paragraph (e)(1) of this section is a post-October capital loss as defined in paragraph (c)(2) of this section, the net capital gain of the company for the taxable year in which the loss arose shall be determined without regard to any long-term capital gain or loss from sales or exchanges after October 31 of the taxable year.

(3) *Amount taken into account in succeeding year.* If a regulated investment company has a post-October capital loss (as defined in paragraph (c)(1) or (c)(2) of this section) for any taxable year, then, for purposes of determining the amount the company may designate as capital gain dividends for the succeeding year, the net capital gain for the succeeding year shall be determined by treating all gains and losses taken into account in computing the post-October capital loss as arising on the first day of the succeeding year.

(f) *Regulated investment company may elect to defer certain losses for purposes of determining taxable income*—(1) *In general.* A regulated investment company may elect, in accordance with the procedures of paragraph (i) of this section, to compute its taxable income for a taxable year without regard to part or all of any post-October capital loss or post-October currency loss for that year.

(2) *Effect of election in current year.* The taxable income of a regulated investment company for a taxable year to which an election under paragraph (f)(1) of this section applies shall be computed without regard to that part of any post-October capital loss or post-October currency loss to which the election applies.

(3) *Amount of loss taken into account in current year*—(i) *If entire amount of net capital loss deferred.* If a regulated investment company elects, under paragraph (f)(1) of this section, to defer the entire amount of a post-October capital loss as defined in paragraph (c)(1) of this section, the taxable income of the company for the taxable year in which the loss arose shall be determined without regard to any capital gains or losses (both long-term and short-term) from sales or exchanges after October 31 of the taxable year.

(ii) *If part of net capital loss deferred*—(A) *In general.* If a regulated investment company elects, under paragraph (f)(1) of this section, to defer less than the entire amount of a post-October capital loss as defined in paragraph (c)(1) of this section, the taxable income of the company for the taxable year in which the loss arose shall be determined by including an amount of capital loss from sales or exchanges after October 31 of the taxable year equal to the amount of the post-October capital loss that is not deferred. No amount of capital gain from sales or exchanges after October 31 of the taxable year shall be taken into account in the determination.

(B) *Character of capital loss not deferred.* The capital loss includible in the taxable income of the company under this paragraph (f)(3)(ii) for the taxable year in which the loss arose shall consist first of any short-term capital losses to the extent thereof, and then of any long-term capital losses, attributable to sales or exchanges after October 31 of the taxable year.

(iii) *If entire amount of net long-term capital loss deferred.* If a regulated investment company elects, under paragraph (f)(1) of this section, to defer the entire amount of a post-October capital loss as defined in paragraph (c)(2) of this section, the taxable income of the company for the taxable year in which the loss arose shall be determined without regard to any long-term capital gains or losses from sales or exchanges after October 31 of the taxable year.

(iv) *If part of net long-term capital loss deferred.* If a regulated investment company elects, under paragraph (f)(1) of this section, to defer less than the entire amount of a post-October capital loss as defined in paragraph (c)(2) of this section, the taxable income of the company for the taxable year in which the loss arose shall be determined by including an amount of long-term capital loss from sales or exchanges after October 31 of the taxable year equal to the amount of the post-October capital loss that is not deferred. No amount of long term capital gain from sales or exchanges after October 31 of the taxable year shall be taken into account in the determination.

(v) *If entire amount of post-October currency loss deferred.* If a regulated investment company elects, under paragraph (f)(1) of this section, to defer the entire amount of a post-October currency loss, the taxable income of the company for the taxable year in which the loss arose shall be determined without regard to any foreign currency gains or losses attributable to transactions after October 31 of the taxable year.

(vi) *If part of post-October currency loss deferred.* If a regulated investment company elects, under paragraph (f)(1) of this section, to defer less than the entire amount of a post-October currency loss, the taxable income of the company for the taxable year in which the loss arose shall be determined by including an amount of foreign currency loss attributable to transactions after October 31 of the taxable year equal to the amount of the post-October currency loss that is not deferred. No amount of foreign currency gain attributable to transactions after October 31 of the taxable year shall be taken into account in the determination.

(4) *Amount of loss taken into account in succeeding year.* If a regulated investment company has a post-October capital loss or a post-October currency loss for any taxable year and an election under paragraph (f)(1) is made for that year, then, for purposes of determining the taxable in-

come of the company for the succeeding year, all capital gains and losses taken into account in determining the post-October capital loss, and all foreign currency gains and losses taken into account in determining the post-October currency loss, that are not taken into account under the rules of paragraph (f)(3) of this section in determining the taxable income of the regulated investment company for the taxable year in which the loss arose shall be treated as arising on the first day of the succeeding year.

(5) *Effect on gross income.* An election by a regulated investment company to defer any post-October capital loss or any post-October currency loss for a taxable year under paragraph (f)(1) of this section shall not affect the amount of the gross income of such company for such taxable year (or the succeeding year) for purposes of section 851(b)(2) or (3).

(g) *Earnings and profits*—(1) *General rule.* The earnings and profits of a regulated investment company for a taxable year are determined without regard to any post-October capital loss or post-October currency loss for that year. If a regulated investment company distributes with respect to a calendar year amounts in excess of the limitation described in the succeeding sentence, then, with respect to those excess amounts, for the taxable year with respect to which the amounts are distributed, the earnings and profits of the company are computed without regard to the preceding sentence. The limitation described in this sentence is the amount that would be the required distribution for that calendar year under section 4982 if "100 percent" were substituted for each percentage set forth in section 4982(b)(1).

(2) *Special Rule—Treatment of losses that are deferred for purposes of determining taxable income.* If a regulated investment company elects to defer, under paragraph (f)(1) of this section, any part of a post-October capital loss or post-October currency loss arising in a taxable year, then, for both the taxable year in which the loss arose and the succeeding year, both the earnings and profits and the accumulated earnings and profits of the company are determined as if the part of the loss so deferred had arisen on the first day of the succeeding year.

(h) *Examples.* The provisions of paragraphs (e), (f), and (g) of this section may be illustrated by the following examples. For each example, assume that X is a regulated investment company that computes its income on a calendar year basis, and that no election is in effect under section 4982(e)(4).

Example (1). X has a $25 net foreign currency gain, a $50 net short-term capital loss, and a $75 net long-term capital gain for the post-October period of 1988. X has no post-October currency loss and no post-October capital loss for 1988, and this section does not apply.

Example (2). X has the following capital gains and losses from sales or exchanges during the periods indicated:

	Long-term	*Short-term*
01/01 - 10/31/88	115	80
	(15)	(20)
	100	60
11/01 - 12/31/88	75	150
	(150)	(50)
	(75)	100
01/01 - 10/31/89	30	40
	(5)	(20)
	25	20
11/01 - 12/31/89	35	100
	(0)	(50)
	35	50

X has a post-October capital loss of $75 for its 1988 taxable year due to a net long-term capital loss for the post-October period of 1988. X does not make an election under paragraph (f)(1) of this section.

(i) *Capital gain dividends.* X may designate up to $100 as a capital gain dividend for 1988 because X must disregard the $75 long-term capital gain and the $150 long-term capital loss for the post-October period of 1988 in computing its net capital gain for this purpose. In computing its net capital gain for 1989 for the purposes of determining the amount it may designate as a capital gain dividend for 1989, X must take into account the $75 long-term capital gain and the $150 long-term capital loss for the post-October period of 1988 in addition to the long-term and short-term capital gains and losses for 1989. Accordingly, X may not designate any amount as a capital gain dividend for 1989.

(ii) *Taxable income.* X must include the $75 long-term capital gain and the $150 long-term capital loss for its post-October period of 1988 in its taxable income for 1988 because it did not make an election under paragraph (f)(1) of this section for 1988. Accordingly, X's taxable income for 1988 will include a net capital gain of $25 and a net short-term capital gain of $160. X's taxable income for 1989 will include a net capital gain of $60 and a net short-term capital gain of $70.

(iii) *Earnings and profits.* X must determine its earnings and profits for 1988 without regard to the $75 long-term capital gain and the $150 long-term capital loss for the post-October period of 1988. X must, however, include the $75 long-term capital gain and $150 long-term capital loss for the post-October period of 1988 in determining its accumulated earnings and profits for 1988. Thus, X includes $260 of capital gain in its earnings and profits for 1988, includes $185 in its accumulated earnings and profits for 1988, and includes $130 of capital gain in its earnings and profits for 1989.

Example (3). Same facts as example (2), except that X elects to defer the entire $75 post-October capital loss for 1988 under paragraph (f)(1) of this section for purposes of determining its taxable income for 1988.

(i) *Capital gain dividends.* Same result as in example (2).

(ii) *Taxable income.* X must compute its taxable income for 1988 without regard to the $75 long-term capital gain and the $150 long-term capital loss for the post-October period of 1988 because it made an election to defer the entire $75 post-October capital loss for 1988 under paragraph (f)(1) of this section. Accordingly, X's taxable income for 1988 will include a net capital gain of $100 and a net short-term capital gain of $160. X must include the $75 long-term capital gain and the $150 long-term capital loss for the post-October period of 1988 in its taxable income for 1989 in addition to the long-term and short-term capital gains and losses for 1989. Accordingly, X's taxable income for 1989 will include a net long-term capital loss of $15 and a net short-term capital gain of $70.

(iii) *Earnings and profits.* For 1988, X must determine both its earnings and profits and its accumulated earnings and profits without regard to the $75 long-term capital gain and $150 long-term capital loss for the post-October period of 1988. In determining both its earnings and profits and its accumulated earnings and profits for 1989, X must include (in addition to the long-term and short-term capital gains and losses for 1989) the $75 long-term capital gain and $150 long-term capital loss for the post-October period of 1988 as if those deferred gains and losses arose on January 1, 1989. Thus, X will include $260 of capital gain in its earnings and profits for 1988 and $55 of capital gain in its earnings and profits for 1989.

Example (4). Same facts as example (2), except that X elects to defer only $50 of the post-October capital loss for 1988 under paragraph (f)(1) of this section for purposes of determining its taxable income for 1988.

(i) *Capital gain dividends.* Same results as in example (2).

(ii) *Taxable income.* X must compute its taxable income for 1988 without regard to the $75 long-term capital gain and $125 of the $150 long-term capital loss for the post-October period of 1988 because it made an election to defer $50 of the $75 post-October capital loss for 1988 under paragraph (f)(1) of this section. Accordingly, X's taxable income for 1988 will include a net capital gain of $75 and a net short-term capital gain of $160. X must include the $75 long-term capital gain and $125 of the $150 long-term capital loss for the post-October period of 1988 in its taxable income for 1989 in addition to the long-term and short-term capital gains and losses for 1989. Accordingly, X's taxable income for 1989 will include a net capital gain of $10 and a net short-term capital gain of $70.

(iii) *Earnings and profits.* X must determine its earnings and profits for 1988 without regard to the $75 long-term capital gain and the $150

long-term capital loss for the post-October period of 1988. X must include $25 of the $150 long-term capital loss for the post-October period of 1988 in determining its accumulated earnings and profits for 1988. In determining both its earnings and profits and its accumulated earnings and profits for 1989, X must include (in addition to the long-term and short-term capital gains and losses for 1989) the $75 long-term capital gain and $125 of the $150 long-term capital loss for the post-October period of 1988 as if those deferred gains and losses arose on January 1, 1989. Thus, X includes $260 of capital gain in its earnings and profits for 1988, includes $235 in its accumulated earnings and profits for 1988, and includes $80 of capital gain in its earnings and profits for 1989.

Example (5). X has the following capital gains and losses from sales or exchanges made during the periods indicated:

	Long-term	*Short-term*
01/01 - 10/31/88	115	80
	(15)	(20)
	100	60
11/01 - 12/31/88	150	50
	(75)	(150)
	75	(100)
01/01 - 10/31/89	30	40
	(5)	(20)
	25	20
11/01 - 12/31/89	35	100
	(0)	(50)
	35	50

X has a post-October capital loss of $25 for its 1988 taxable year due to a net capital loss for the post-October period of 1988. X does not make an election under paragraph (f)(1) of this section.

(i) *Capital gain dividends.* X may designate up to $100 as a capital gain dividend for 1988 because X must disregard the $150 long-term capital gain, the $75 long- term capital loss, the $50 short-term capital gain, and the $150 short-term capital loss for the post-October period of 1988 in computing its net capital gain for this purpose. In computing its net capital gain for 1989 for purposes of determining the amount it may designate as a capital gain dividend for 1989, X must take into account the $150 long-term capital gain, the $75 long-term capital loss, the $50 short-term capital gain, and the $150 short-term capital loss for the post-October period of 1988 in addition to the long-term and short-term capital gains and losses for 1989. Accordingly, X may designate up to $105 as a capital gain dividend for 1989.

(ii) *Taxable income.* X must include the $150 long-term capital gain, the $75 long-term capital loss, the $50 short-term capital gain, and the $150 short-term capital loss for the post-October period of 1988 in its taxable income for 1988 because it did not make an election under paragraph (f)(1) of this section for 1988. Accordingly, X's taxable income for 1988 will include a net capital gain of $135 (consisting of a net long-term capital gain of $175 and a net short-term capital loss of $40). X's taxable income for 1989 will include a net capital gain of $60 and a net short-term capital gain of $70.

(iii) *Earnings and profits.* X must determine its earnings and profits for 1988 without regard to the $150 long-term capital gain, the $75 long-term capital loss, the $50 short-term capital gain, and the $150 short-term capital loss for the post-October period of 1988. X must, however, include the $150 long-term capital gain, the $75 long-term capital loss, the $50 short-term capital gain, and the $150 short-term capital loss for the post-October period of 1988 in determining its accumulated earnings and profits for 1988. Thus, X includes $160 of capital gain in its earnings and profits for 1988, includes $135 in its accumulated earnings and profits for 1988, and includes $130 of capital gain in its earnings and profits for 1989.

Example (6). Same facts as example (5), except that X elects to defer the entire $25 post-October capital loss for 1988 under paragraph (f)(1) of this section for purposes of determining its taxable income for 1988.

(i) *Capital gain dividends.* Same result as in example (5).

(ii) *Taxable income.* X must compute its taxable income for 1988 without regard to the $150 long-term capital gain, the $75 long-term capital loss, the $50 short-term capital gain, and the $150 short-term capital loss for the post-October period of 1988 because it made an election to defer the entire $25 post-October capital loss for 1988 under paragraph (f)(1) of this section. Accordingly, X's taxable income for 1988 will include a net capital gain of $100 and a net short-term capital gain of $60. X must include the $150 long-term capital gain, the $75 long-term capital loss, the $50 short-term capital gain, and the $150 short-term capital loss for the post-October period of 1988 in its taxable income for 1989 in addition to the long-term and short-term capital gains and losses for 1989. Accordingly, X's taxable income for 1989 will include a net capital gain of $105 (consisting of a net long-term capital gain of $135 and a net short-term capital loss of $30).

(iii) *Earnings and profits.* For 1988, X must determine both its earnings and profits and its accumulated earnings and profits without regard to the $150 long-term capital gain, the $75 long-term capital loss, the $50 short-term capital gain, and the $150 short-term capital loss for the post-October period of 1988. In determining both its earnings and profits and its accumulated earnings and profits for 1989, X must include (in addition to the long-term and short-term capital gains and losses for 1989) the $150 long-term capital gain, the $75 long-term capital loss, the $50 short-term capital gain, and the $150 short-term capital loss for the post-October period of 1988 as if those deferred gains and losses arose on January 1, 1989. Thus, X will include $160 of capital gain in its earnings and profits for 1988 and $105 of capital gain in its earnings and profits for 1989.

Example (7). Same facts as example (5), except that X elects to defer only $20 of the post-October capital loss for 1988 under paragraph (f)(1) of this section for purposes of determining its taxable income for 1988.

(i) *Capital gain dividends.* Same result as in example (5).

(ii) *Taxable income.* X must compute its taxable income for 1988 by including $5 of the $150 short-term capital loss for the post-October period of 1988, but without regard to the $150 long-term capital gain, the $75 long-term capital loss, the $50 short-term capital gain, and $145 of the $150 short-term capital loss for the post-October period of 1988 because it made an election to defer $20 of the $25 post-October capital loss for 1988 under paragraph (f)(1) of this section. Accordingly, X's taxable income for 1988 will include a net capital gain of $100 and a net short-term capital gain of $55. X must include the $150 long-term capital gain, the $75 long-term capital loss, the $50 short-term capital gain, and $145 of the $150 short-term capital loss for the post-October period of 1988 in its taxable income for 1989 in addition to the long-term and short- term capital gains and losses for 1989. Accordingly, X's taxable income for 1989 will include a net capital gain of $110 (consisting of a long-term capital gain of $135 and a net short-term capital loss of $25).

(iii) *Earnings and profits.* X must determine its earnings and profits for 1988 without regard to the $150 long-term capital gain, the $75 long-term capital loss, the $50 short-term capital gain, and the $150 short-term capital loss for the post-October period of 1988. In determining its accumulated earnings and profits for 1988, X must include $5 of the $150 short-term capital loss for the post-October period of 1988. In determining its accumulated earnings and profits for 1989, X must include (in addition to the long-term and short-term capital gains and losses for 1989) the $150 long-term capital gain, the $75 long-term capital loss, the $50 short-term capital gain, and $145 of the $150 short-term capital loss for the post-October period of 1988 as if those deferred gains and losses arose on January 1, 1989. Thus, X includes $160 of capital gain in its earnings and profits for 1988, includes $155 in its accumulated earnings and profits for 1988, and includes $110 of capital gain in its earnings and profits for 1989.

Example (8). X has the following capital gains and losses from sales or exchanges made during the periods indicated:

	Long-term	*Short-term*
01/01 - 10/31/88	115	80
	(15)	(20)
	100	60
11/01 - 12/31/88	15	25
	(75)	(10)
	(60)	15
01/01 - 10/31/89	80	50
	(5)	(100)
	75	(50)
11/01 - 12/31/89	85	40
	(0)	(20)
	85	20

X has a post-October capital loss of $45 for its 1988 taxable year due to a net capital loss for the post-October period of 1988. X does not make an election under paragraph (f)(1) of this section.

(i) *Capital gain dividends.* X may designate up to $100 as a capital gain dividend for 1988 because X must disregard the $15 long-term capital gain, the $75 long- term capital loss, the $25 short-term capital gain, and the $10 short-term capital loss for the post-October period of 1988 in computing its net capital gain for this purpose. In computing its net capital gain for

1989 for purposes of determining the amount it may designate as a capital gain dividend for 1989, X must take into account the $15 long-term capital gain, the $75 long-term capital loss, the $25 short-term capital gain, and the $10 short-term capital loss for the post-October period of 1988 in addition to the long-term and short-term capital gains and losses for 1989. Accordingly, X may designate up to $85 as a capital gain dividend for 1989.

(ii) *Taxable income.* X must include the $15 long-term capital gain, the $75 long-term capital loss, the $25 short-term capital gain, and the $10 short-term capital loss for the post-October period of 1988 in its taxable income for 1988 because it did not make an election under paragraph (f)(1) of this section for 1988. Accordingly, X's taxable income for 1988 will include a net capital gain of $40 and a net short-term capital gain of $75. X's taxable income for 1989 will include a net capital gain of $130 for 1989 (consisting of a net long-term capital gain of $160 and a net short-term capital loss of $30).

(iii) *Earnings and profits.* X must determine its earnings and profits for 1988 without regard to the $15 long-term capital gain, the $75 long-term capital loss, the $25 short-term capital gain, and the $10 short-term capital loss for the post-October period of 1988. X must, however, include the $15 long-term capital gain, the $75 long-term capital loss, the $25 short-term capital gain, and the $10 short-term capital loss for the post-October period of 1988 in determining its accumulated earnings and profits for 1988. Thus, X includes $160 of capital gain in its earnings and profits for 1988, includes $115 in its accumulated earnings and profits for 1988, and includes $130 of capital gain in its earnings and profits for 1989.

Example (9). Same facts as example (8), except that X elects to defer the entire $45 post-October capital loss for 1988 under paragraph (f)(1) of this section for purposes of determining its taxable income for 1988.

(i) *Capital gain dividends.* Same result as in example (8).

(ii) *Taxable income.* X must compute its taxable income for 1988 without regard to the $15 long-term capital gain, the $75 long-term capital loss, the $25 short-term capital gain, and the $10 short-term capital loss for the post-October period of 1988 because it made an election to defer the entire $45 post-October capital loss for 1988 under paragraph (f)(1) of this section. Accordingly, X's taxable income for 1988 will include a net capital gain of $100 and a net short-term capital gain of $60. X must include the $15 long-term capital gain, the $75 long-term capital loss, the $25 short-term capital gain, and the $10 short-term capital loss for the post-October period of 1988 in its taxable income for 1989 in addition to the long-term and short-term capital gains and losses for 1989. Accordingly, X's taxable income for 1989 will include a net capital gain of $85 (consisting of a net long-term capital gain of $100 and a net short-term capital loss of $15).

(iii) *Earnings and profits.* For 1988, X must determine both its earnings and profits and its accumulated earnings and profits without regard to the $15 long-term capital gain, the $75 long-term capital loss, the $25 short-term capital gain, and the $10 short-term capital loss for the post-October period of 1988. In determining both its earnings and profits and its accumulated earnings and profits for 1989, X must include (in addition to the long-term and short-term capital gains and losses for 1989) the $15 long-term capital gain, the $75 long-term capital loss, the $25 short-term capital gain, and the $10 short-term capital loss for the post-October period of 1988 as if those deferred gains and losses arose on January 1, 1989. Thus, X will include $160 of capital gain in its earnings and profits for 1988 and $85 of capital gain in its earnings and profits for 1989.

Example (10). Same facts as example (8), except that X elects to defer only $30 of the post-October capital loss for 1988 under paragraph (f)(1) of this section for purposes of determining its taxable income for 1988.

(i) *Capital gain dividends.* Same result as in example (8).

(ii) *Taxable income.* X must compute its taxable income for 1988 by including $5 of the $75 long-term capital loss and the $10 short-term capital loss for the post-October period of 1988, but without regard to the $15 long-term capital gain, $70 of the $75 long-term capital loss, and the $25 short-term capital gain for the post-October period of 1988 because it made an election to defer $30 of the $45 post-October capital loss for 1988 under paragraph (f)(1) of this section. Accordingly, X's taxable income for 1988 will include a net capital gain of $95 and a net short-term capital gain of $50. X must include the $15 long-term capital gain, $70 of the $75 long-term capital loss, and the $25 short-term capital gain for the post-October period of 1988 in its taxable income for 1989 in addition to the long-term and short-term capital gains and losses for 1989. Accordingly, X's taxable income for 1989 will include a net capital gain of $100 (consisting of a net long-term capital gain of $105 and a net short-term capital loss of $5).

(iii) *Earnings and profits.* X must determine its earnings and profits for 1988 without regard to the $15 long-term capital gain, the $75 long-term capital loss, the $25 short-term capital gain, and the $10 short-term capital loss for the post-October period of 1988. In determining its accumulated earnings and profits for 1988, X must include $5 of the $75 long-term capital loss and the $10 short-term capital loss for the post-October period of 1988. In determining both its earnings and profits and its accumulated earnings and profits for 1989, X must include (in addition to the long-term and short-term capital gains and losses for 1989) the $15 long-term capital gain, $70 of the $75 long-term capital loss, and the $25 short-term capital gain for the post-October period of 1988 as if those deferred gains and losses arose on January 1, 1989. Thus, X includes $160 of capital gain in its earnings and profits for 1988, includes $145 in its accumulated earnings and profits for 1989, and includes $100 of capital gain in its earnings and profits for 1989 (consisting of a net long-term capital gain of $105 and a net short-term capital loss of $5).

Example (11). X has the following foreign currency gains and losses attributable to transactions during the periods indicated:

01/01	-	10/31/88	200
11/01	-	12/31/88	(100)
01/01	-	10/31/89	110
11/01	-	12/31/89	40

X has a $100 post-October currency loss for its 1988 taxable year due to a net foreign currency loss for the post-October period of 1988. X does not make an election under paragraph (f)(1) of this section.

(i) *Taxable income.* X must compute its taxable income for 1988 by including the $100 foreign currency loss for the post-October period of 1988 because it did not make an election under paragraph (f)(1) of this section. Accordingly, X's taxable income for 1988 will include a net foreign currency gain of $100. X's taxable income for 1989 will include a net foreign currency gain of $150.

(ii) *Earnings and profits.* X must determine its earnings and profits for 1988 without regard to the foreign currency loss for the post-October period of 1988. X must, however, include the $100 foreign currency loss for the post-October period of 1988 in determining its accumulated earnings and profits for 1988. Thus, X includes $200 of foreign currency gain in its earnings and profits for 1988, includes $100 in its accumulated earnings and profits for 1988, and includes $150 of foreign currency gain in its earnings and profits for 19

Example (12). Same facts as exa[illegible] (11), except that X elects to defer the entire $100 post-October currency loss for 1988 under paragraph (f)(1) of this section for purposes of determining its taxable income for 1988.

(i) *Taxable income.* X must compute its taxable income for 1988 without regard to the $100 foreign currency loss for the post-October period of 1988 because it made an election to defer the entire $100 post-October currency loss for 1988 under paragraph (f)(1) of this section. Accordingly, X's taxable income for 1988 will include a net foreign currency gain of $200. X's taxable income for 1989 will include a net foreign currency gain of $50 because X must compute its taxable income for 1989 by including the $100 foreign currency loss for the post-October period of 1988 in addition to the foreign currency gains and losses for 1989.

(ii) *Earnings and profits.* For 1988, X must determine both its earnings and profits and its accumulated earnings and profits without regard to the $100 foreign currency loss for the post-October period of 1988. In determining both its earnings and profits and its accumulated earnings and profits for 1989, X must include (in addition to the foreign currency gains and losses for 1989) the $100 foreign currency loss for the post-October period of 1988 as if that deferred loss arose on January 1, 1989. Thus, X will include $200 of foreign currency gain in its earnings and profits for 1988 and $50 of foreign currency gain in its earnings and profits for 1989.

Example (13). Same facts as example (11), except that X elects to defer only $75 of the post-October currency loss under paragraph (f)(1) of this section for purposes of determining its taxable income for 1988.

(i) *Taxable income.* X must compute its taxable income for 1988 by including $25 of the $100 foreign currency loss for the post-October period of 1988, but without regard to $75 of the $100 foreign currency loss for the post-October period of 1988 because it made an election to defer $75 of the $100 post-October currency loss for 1988 under paragraph (f)(1) of this section. Accordingly, X's taxable income for 1988 will include a net foreign currency gain of $175. X's taxable

income will include a net foreign currency gain of $75 for 1989 because X must compute its taxable income for 1989 by including $75 of the $100 foreign currency loss for the post-October period of 1988 in addition to the foreign currency gains and losses for 1989.

(ii) *Earnings and profits.* X must determine its earnings and profits for 1988 without regard to the $100 foreign currency loss for the post-October period of 1988. X must, however, include $25 of the $100 foreign currency loss for the post-October period of 1988 in determining its accumulated earnings and profits for 1988. In determining both its earnings and profits and its accumulated earnings and profits for 1989, X must include (in addition to the foreign currency gains and losses for 1989) the $75 of the $100 foreign currency loss for the post-October period of 1988 as if that loss arose on January 1, 1989. Thus, X includes $200 of foreign currency gain in its earnings and profits for 1988, includes $175 in its accumulated earnings and profits for 1988, and includes $75 of foreign currency gain in its earnings and profits for 1989.

(i) *Procedure for making election*—(1) *In general.* Except as provided in paragraph (i)(2) of this section, a regulated investment company may make an election under paragraph (f)(1) of this section for a taxable year to which this section applies by completing its income tax return (including any necessary schedules) for that taxable year in accordance with the instructions for the form that are applicable to the election.

(2) *When applicable instructions not available.* If the instructions for the income tax returns of regulated investment companies for a taxable year to which this section applies do not reflect the provisions of this section, a regulated investment company may make an election under paragraph (f)(1) of this section for that year by entering the appropriate amounts on its income tax return (including any necessary schedules) for that year, and by attaching a written statement to the return that states—

(i) The taxable year for which the election under this section is made;

(ii) The fact that the regulated investment company elects to defer all or a part of its post-October capital loss or post-October currency loss for that taxable year for purposes of computing its taxable income under the terms of this section;

(iii) The amount of the post-October capital loss or post-October currency loss that the regulated investment company elects to defer for that taxable year; and

(iv) The name, address, and employer identification number of the regulated investment company.

(j) *Transition rules*—(1) *In general.* For a taxable year ending before March 2, 1990 in which a regulated investment company incurred a post-October capital loss or post-October currency loss, the company may use any method that is consistently applied and in accordance with reasonable business practice to determine the amounts taken into account in that taxable year for purposes of paragraphs (e)(2), (f)(3), and (g) of this section and to determine the amount taken into account in the succeeding year for purposes of paragraphs (e)(3), (f)(4), and (g) of this section. For example, for purposes of paragraph (e), a taxpayer may use a method that treats as incurred in a taxable year all capital gains from sales or exchanges after October 31 of that year and an amount of capital loss for such period equal to the amount of such gains and that treats the remaining amount of capital loss for such period as arising on the first day of the succeeding year. Similarly, for purposes of paragraph (e)(3), a taxpayer may use a method that treats as arising on the first day of the succeeding year only the excess of the capital losses from sales or exchanges after October 31 over the capital gains for such period (that is, the net capital loss or net long-term capital loss for such period).

(2) *Retroactive election*—(i) *In general.* A regulated investment company may make an election under paragraph (f)(1) for a taxable year with respect to which it has filed an income tax return on or before May 1, 1990 (a "retroactive election") by filing an amended return (including any necessary schedules) for that taxable year reflecting the appropriate amounts and by attaching a written statement to the return that complies with the requirements of paragraph (i)(2) of this section.

(ii) *Deadline for making election.* A retroactive election may be made no later than December 31, 1990.

(3) *Amended return required for succeeding year in certain circumstances*—(i) *In general.* If, at the time a regulated investment company makes a retroactive election under this section, it has already filed an income tax return for the succeeding year, the company must file an amended return for such succeeding year reflecting the appropriate amounts.

(ii) *Time for filing amended return.* An amended return required under paragraph (j)(3)(i) of this section must be filed together with the amended return described in paragraph (j)(2)(i).

(4) *Retroactive dividend.* A regulated investment company that makes a retroactive election under this section for a taxable year may pay a dividend (a "retroactive dividend") with respect to that taxable year.

(5) *Deduction for dividends paid*—(i) *In general.* Subject to the rules of sections 561 and 562, a regulated investment company shall include the amount of any retroactive dividend paid under paragraph (j)(4) of this section in computing its deduction for dividends paid for the year to which the retroactive dividend relates.

(ii) *Declaration and payment date.* A retroactive dividend must be declared with respect to a taxable year on or before the date a retroactive election is made for that year under this section, and must be paid (or treated as paid under section 852(b)(7)) on or before December 31, 1990. No deduction for dividends paid shall be allowed under paragraph (j)(5)(i) of this section for any amount not paid (or treated as paid) on or before December 31, 1990.

(iii) *Limitation on ordinary dividends.* The amount of retroactive dividends (other than retroactive dividends qualifying as capital gain dividends) paid for a taxable year with respect to which a retroactive election is made under this section shall not exceed the increase, if any, in the investment company taxable income of the regulated investment company (determined without regard to the deduction for dividends paid (as defined in section 561)) that is attributable solely to the regulated investment company having made such election.

(iv) *Limitation on capital gain dividends.* The amount of retroactive dividends qualifying as capital gain dividends paid for a taxable year with respect to which a retroactive election was made under this section shall not exceed the increase, if any, in the

amount of the excess described in section 852(b)(3)(A) (relating to the excess of the net capital gain over the deduction for capital gain dividends paid) that is attributable solely to the regulated investment company having made such election.

(v) *Effect on other years.* A retroactive dividend shall not be includible in computing the deduction for dividends paid for—

(A) The taxable year in which such distribution is actually paid (or treated as paid under section 852(b)(7)); or

(B) Under section 855(a), the taxable year preceding the taxable year with respect to which a retroactive election was made.

(vi) *Example.* The provisions of this paragraph (j)(5) may be illustrated by the following example:

Example. X is a regulated investment company that computes its income on a calendar year basis. No election is in effect under section 4982(e)(4). X has the following income for 1988:

FOREIGN CURRENCY GAINS AND LOSSES:

	Gains and Losses
Jan. 1 - Oct. 31	100
Nov. 1 - Dec. 31	(75)

CAPITAL GAINS AND LOSSES:

	Short-Term	*Long-Term*
Jan. 1 - Oct. 31	100	100
Nov. 1 - Dec. 31	50	(100)

(i) X had investment company taxable income of $175 and no net capital gain for 1988 for taxable income purposes. X distributed $175 of investment company taxable income as an ordinary dividend for 1988.

(ii) If X makes a retroactive election under this section to defer the entire $75 post-October currency loss and the entire $50 post-October capital loss for the post-October period of its 1988 taxable year for purposes of computing its taxable income, that deferral increases X's investment company taxable income for 1988 by $25 (due to an increase in foreign currency gain of $75 and a decrease in short-term capital gain of $50) to $200 and increases the excess described in section 852(b)(3)(A) for 1988 by $100 from $0 to $100. The amount that X may distribute as a retroactive dividend is limited to $25, and the amount that X may distribute as a retroactive capital gain dividend is limited to $100.

(k) *Effective date.* The provisions of this section shall apply to taxable years ending after October 31, 1987.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. Section 602.101(c) is amended by inserting in the appropriate place in the table:

"1.852—11T . . . 1545-1094".

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is impracticable to issue this Treasury decision with notice and public procedure under section (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

Charles H. Brennan,
Acting Commissioner of Internal Revenue.

Approved January 18, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 30, 1990, 8:45 a.m., and published in the issue of the Federal Register for January 31, 1990, 55 F.R. 3211)

Subchapter N.—Tax Based on Income from Sources Within or Without the United States

Part I.—Determination of Sources of Income

Section 861.—Income from Sources Within the United States

26 CFR 1.861-8: Computation of taxable income from sources within the United States and from other sources and activities.

T.D. 8286

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Apportionment of Expenses in the FSC and DISC Contexts

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final Income Tax Regulations relating to apportionment of expenses in the Foreign Sales Corporations (FSC) and Domestic International Sales Corporation (DISC) contexts. This action is being taken in order to discontinue the apportionment of expenses of the related supplier of a DISC or a FSC to dividends from the DISC or FSC. This regulation is necessary to prevent a second apportionment to the dividend from a FSC or DISC of expenses already apportioned to determine the combined taxable income of the FSC or DISC and its related supplier.

EFFECTIVE DATE: These regulations are effective for taxable years beginning after December 31, 1986.

SUPPLEMENTARY INFORMATION

Background

On May 17, 1988, the FEDERAL REGISTER published proposed amendments (53 FR 17473) [INTL-128-87, 1988-1 C.B. 917] to the Income Tax Regulations (26 CFR Part 1) under section 861(b) of the Internal Revenue Code of 1986. Corrections were published in the FEDERAL REGISTER on May 27, 1988 (53 FR 19369). Written comments responding to this notice were received. A public hearing was not requested and none was held. After consideration of all comments regarding the proposed amendments, those amendments are adopted by this Treasury Decision with revisions in response to those comments. The comments and revisions are discussed below.

Explanation of provisions

The language in §1.861-8(f)(1)(vi)-(C) as proposed has been moved to §1.861-8(f)(2)(ii) and modified to clarify that for taxable years beginning after December 31, 1986, there will not be a "second stage" apportionment whenever either of the administrative pricing methods of sections 994 and 925 (*i.e.*, the combined taxable income method and the gross receipts method) is used to determine the profit of the DISC or FSC, respectively.

Subdivision (iii)(A) of *Example* (23) in §1.861-8(g) is modified to clarify that the statutory grouping is gross income from R's sale of the export property, the electronic equipment, and not gross income under section 863(b).

One commentator suggested that the proposed regulations at subdivision (iv) of §1.861-8(g) *Example* (23) incorrectly determined, relying on section 927(e)(1), the related supplier's foreign source income from the export sales. Section 927(e)(1) provides that the foreign source income of the related supplier of a FSC from trans-

actions which give rise to foreign trading gross receipts may not exceed the foreign source income that would have been earned by the related supplier had the analogous DISC pricing rule applied to the transaction. Accordingly, the proposed regulations, in applying section 927(e)(1), determined the related supplier's foreign source income using the 50% combined taxable income DISC pricing method which is analogous to the 23% combined taxable income FSC pricing method. The proposed regulations did not apply the second stage apportionment of general and administrative expenses and research and development expenses to the DISC dividends in determining what would have been the related supplier's foreign source income from the sales. The commentator suggested that the failure to use the second stage apportionment procedure did not follow Congressional intent to maintain parity in the level of foreign source income whether the transaction involves a FSC or a DISC prior to the enactment of the Tax Reform Act of 1986 (Pub. L. 99-514) [1986-3 C.B. (Vol. 1) 1] since the second stage apportionment procedure could be used to determine a related supplier's foreign source income in 1986.

We believe, however, that section 927(e)(1) requires only a comparison to the analogous DISC pricing method as applicable for the year in which the related supplier's foreign source income is being determined. Therefore, the second stage apportionment procedure may be used only with regard to taxable years beginning before January 1, 1987, since the procedure is only applicable to those years. See subdivision (iv) of §1.861-8(g) *Example* (22) and subdivision (vi) of §1.861-8(g) *Example* (23).

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required.

* * * * *

Adoption of amendments to the Regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Part 1—INCOME TAX REGULATIONS

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805.***

Par. 2. Section 1.861-8 is amended by revising paragraph (f)(1)(iii), by removing and reserving paragraphs (f)(1)(ii) and (f)(1)(vi)(C), by designating paragraph (f)(2) as (f)(2)(i) and by adding a new paragraph (f)(2)(ii) to read as follows:

§1.861-8 Computation of taxable income from sources within the United States and from other sources and activities.

* * * * *

(f) *Miscellaneous matters*—(1) *Operative sections.****

(iii) *DISC and FSC taxable income.* Sections 925 and 994 provide rules for determining the taxable income of a FSC and DISC, respectively, with respect to qualified sales and leases of export property and qualified services. The combined taxable income method available for determining a DISC's taxable income provides, without consideration of export promotion expenses, that the taxable income of the DISC shall be 50 percent of the combined taxable income of the DISC and the related supplier derived from sales and leases of export property and from services. In the FSC context, the taxable income of the FSC equals 23 percent of the combined taxable income of the FSC and the related supplier. Pursuant to regulations under sections 925 and 994, this section provides rules for determining the deductions to be taken into account in determining combined taxable income, except to the extent modified by the marginal costing rules set forth in the regulations under sections 925(b)(2) and 994(b)(2) if used by the taxpayer. See *Examples* (22) and (23) of paragraph (g) of this section. In addition, the computation of combined taxable income is necessary to determine the applicability of the section 925(d) limitation and the "no loss" rules of the regulations under sections 925 and 994.

* * * * *

(vi) ***

(C) [RESERVED].

* * * * *

(2) *Application to more than one operative section.* (i) ***

(ii) When expenses, losses, and other deductions that have been properly allocated and apportioned between combined gross income of a related supplier and a DISC or former DISC and residual gross income, regardless of which of the administrative pricing methods of section 994 has been applied, such deductions are not also allocated and apportioned to gross income consisting of distributions from the DISC or former DISC attributable to income of the DISC or former DISC as determined under the administrative pricing methods with respect to DISC or former DISC taxable years beginning after December 31, 1986. Accordingly, *Example* (22) of paragraph (g) of this section does not apply to distributions from a DISC or former DISC with respect to DISC or former DISC taxable years beginning after December 31, 1986. This rule does not apply to the extent that the taxable income of the DISC or former DISC is determined under the section 994(a)(3) transfer pricing method. In addition, for taxable years beginning after December 31, 1986, in the case of expenses, losses, and other deductions that have been properly allocated and apportioned between combined gross income of a related supplier and a FSC and residual gross income, regardless of which of the administrative pricing methods of section 925 has been applied, such deductions are not also allocated and apportioned to gross income consisting of distributions from the FSC or former FSC which are attributable to the foreign trade income of the FSC or former FSC as determined under the administrative pricing methods. This rule does not apply to the extent that the foreign trade income of the FSC or former FSC is determined under the section 925(a)(3) transfer pricing method. See *Example* (23) of paragraph (g) of this section.

* * * * *

Par. 3. *Example* (22) of §1.861-8(g) is amended by adding immediately

after subdivision (iii) a subdivision (iv) to read as follows:

§1.861-8 Computation of taxable income from sources within the United States and from other sources and activities.

* * * * *

(g) *General examples.****

*Example (22).****

(iv) This *Example* (22) applies only to DISC taxable years ending before January 1, 1987, and to distributions from a DISC or former DISC with respect to DISC or former DISC taxable years ending before January 1, 1987.

* * * * *

Par. 4. *Example* (23) of §1.861-8(g) is removed and replaced with new *Example* (23) to read as follows:

§1.861-8 Computation of taxable income from sources within the United States and from other sources and activities.

* * * * *

(g) *General examples.****

Example (23)—Foreign Sales Corporations—(i) *Facts.* R, a domestic corporation, manufactures a product line of electronic equipment and sells it to retailers both in the United States and in foreign countries. On January 1, 1988, R established FSC, a wholly owned corporation, in a possession of the United States. FSC elected under section 922(a)(2) foreign sales corporation status. Both R and FSC are calendar year corporations. R entered into a written agreement with FSC whereby FSC was granted a sales franchise with respect to the export sales of the electronic equipment, which is export property as defined in section 927(a). Under the agreement, FSC would receive commissions with respect to those exports equal to the maximum amount permitted to be received under the administrative pricing rules of section 925(a)(1) and (2). The maximum amount will equal the expenses incurred by FSC plus the maximum profit permitted to be earned by FSC under the pricing rules. In 1988, the profit earned by FSC was $354,424. This profit was determined using the combined taxable income administrative pricing method of section 925(a)(2). FSC paid taxes to the United States in the amount of $41,914 (*i.e.*, $354,424 × 8/23 × .34). The FSC did not pay any foreign tax. On September 15, 1989, FSC paid R a dividend of $312,510 (*i.e.*, profit less United States tax). The 100% dividends received deduction of section 245(c) applied to this dividend. In 1988, R had total export sales of $7,700,000 for which its cost of goods sold was $6,000,000. Thus, its gross income on those sales was $1,700,000. Those sales occurred outside the United States. Moreover, R had U.S. domestic sales of $12,000,000 on which it earned gross income of $900,000. R received royalty income from the foreign license of its electronic technology in the amount of $1,000,000. R's deductible general and administrative expenses allocable to all gross income are $125,000. For purposes of this example, it is assumed that R did not incur any research and development expenses. In addition, it is assumed that R did not incur any direct selling expenses with respect to either its domestic or foreign sales. FSC incurred $100,000 of expenses relating to the activities and functions referred to in section 924(c), (d) and (e). FSC will receive the maximum commission and profit under the combined taxable income method of section 925(a)(2). Under this method, FSC will receive a profit equal to 23% of the combined taxable income attributable to the export sale of the electronic equipment computed on a product line basis.

(ii) *Allocation.* For purposes of determining combined taxable income of R and FSC from export sales, R's general and administrative expenses of $125,000 must be allocated to and apportioned between gross income resulting from the production and sale of the electronic equipment for foreign markets, and from the production and sale of the electronic equipment for the domestic market.

(iii) *Apportionment*—(A) *Combined Taxable Income.* In order to compute the combined taxable income from the production and sale of the electronic equipment, R's general and administrative expenses of $125,000 are apportioned between the statutory grouping of gross income from the export of the electronic equipment and the residual grouping of gross income from domestic sales and foreign licenses. None of R's general and administrative expenses are apportioned to the FSC distribution of $312,510. In the absence of more specific or contrary information, R's general and administrative expenses may be apportioned on the basis of gross income in the respective groupings, as follows:

Apportionment of general and administrative expenses to the statutory grouping, gross income from exports of electronic equipment:

$$\$125{,}000 \times \frac{\$1{,}700{,}000}{(\$1{,}700{,}000 + \$900{,}000 + \$1{,}000{,}000)} = \$59{,}028$$

Apportionment of general and administrative expenses to the residual grouping, gross income from domestic sales of electronic equipment, foreign royalty income from licensing electronic equipment technology:

$$\$125{,}000 \times \frac{(\$900{,}000 + \$1{,}000{,}000)}{(\$1{,}700{,}000 + \$900{,}000 + \$1{,}000{,}000)} = \$65{,}972$$

Total apportionment of general and administrative expenses		$125,000

On the basis of this apportionment, the combined taxable income and FSC's portion of the combined taxable income may be calculated as follows:

Gross income from exports		$1,700,000
Less: FSC section 924(c), (d) and (e) expenses	$100,000	
Apportioned general and administrative expenses	$ 59,028	
Total expenses		(159,028)
Combined taxable income		$1,540,972
FSC's income—		
23% of combined taxable income		$ 354,424

(B) *R's taxable income.* R's total taxable income from the export sales equals 77% of combined taxable income and is computed as follows:

Gross receipts	$7,700,000	
Cost of goods sold	6,000,000	
Gross income	$1,700,000	
Less:		
Apportioned general and administrative expenses		$ 59,028
Commission to FSC		454,424
Total		$ (513,452)
R's taxable income		$1,186,548

As illustrated, all of the general and administrative expenses apportioned to combined taxable income are taken as deductions in computing R's taxable income.

(C) *R's foreign source royalty income.* In order to determine the amount of taxable income of R from sources without the United States relating to the royalty income, the remaining general and administrative expenses of $65,972 are apportioned between the statutory grouping, foreign royalty income, and the residual grouping of gross income from sources within the United States. The computations below illustrate this apportionment:

Apportionment of the general and administrative expenses to the statutory grouping, foreign royalty income:

$$\$65,972 \times \frac{\$1,000,000}{(\$1,000,000 + \$900,000)} = \$34,722$$

Apportionment of general and administrative expenses to the residual grouping, gross income from domestic sales of electronic equipment:

$$\$65,972 \times \frac{\$900,000}{(\$1,000,000 + \$900,000)} = \$31,250$$

(iv) *R's foreign source income from the sales using FSC as a commission agent.* R's section 863(b) gross income of $1,700,000 from the export sales of electronic equipment manufactured in the United States and sold in foreign countries will qualify for sourcing partly from within and partly from without the United States in accordance with §1.863-3. R's income is sourced on the basis of *Example* (2) of §1.863-3(b)(2). *See* Notice 89-11, 1989-1 C.B. 632. Accordingly, one-half of R's gross income ($850,000) would qualify as foreign source gross income. Therefore, assuming all of R's expenses are apportioned on a gross basis, R's foreign source taxable income will be $593,274. However, since the export sales were made using a foreign sales corporation as a commission agent on the sale, section 927(e)(1) will operate to limit R's foreign source taxable income to $385,243. Under section 927(e)(1), R's foreign source taxable income on the export transaction may not exceed the amount which would have been treated as foreign source taxable income had the comparable DISC pricing rule, in this case the 50% of combined taxable income method, been used to compute FSC's profit. The calculations under section 927(e)(1) are as follows (for purposes of this example, it is assumed that there are no export promotion expenses):

Combined Taxable Income (CTI)	$1,540,972
DISC income (50% of CTI)	770,486
R's income (50% of CTI)	770,486
Source of R's taxable income had the DISC pricing method applied:	
U.S. source	$ 385,243
Foreign source	$ 385,243

(v) *Research and development expenses.* For purposes of this example, it was assumed R did not incur any research and development expenses (R & D expenses). Had R incurred R & D expenses, for purposes of computing the combined taxable income from the production and sale of the electronic equipment, those R & D expenses would have been allocated and apportioned between the statutory grouping of gross income from the export of the electronic equipment and the residual grouping of gross income from domestic sales and foreign licenses. R & D expenses would also have been apportioned to R's export sales and royalty income in order to determine R's section 863(b) taxable income from export sales. As with the apportionment of general and administrative expenses, none of the R & D expenses are apportioned to the dividends from the FSC.

(vi) *Apportionment of expenses in a DISC context.* For taxable years beginning after December 31, 1986, general and administrative expenses and R&D expenses of a related supplier in a DISC context are also allocated and apportioned as illustrated in this example. None of the expenses are apportioned to DISC dividends.

* * * * *

Par. 5. Section 1.861-8T(f)(1)(iii) is redesignated as 1.861-8T(f)(1)(ii).

Michael J. Murphy,
Acting Commissioner of Internal Revenue.

Approved January 5, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 29, 1990, 8:45 a.m., and published in the issue of the Federal Register for January 30, 1990, 55 F.R. 3051)

Part II.—Nonresident Aliens and Foreign Corporations

Subpart A.—Nonresident Alien Individuals

Section 872.—Gross Income

26 CFR 1.872-2: Exclusions from gross income of nonresident alien individuals.

Article 2(2) of an executive agreement between the United States and Argentina, concluded under sections 872(b) and 883, does not exclude from U.S. taxation under section 897 gain from the disposition of a U.S. real property interest realized by an Argentine enterprise engaged in the interntional operation of ships or aircraft. See Rev. Rul. 90-37, below.

Subpart B.—Foreign Corporations

Section 883.—Exclusions from Gross Income

26 CFR 1.883-1: Exclusions from gross income of foreign corporations.
(Also Sections 872, 897; 1.872-2.)

U.S. and Argentina Agreement; gain from disposition of U.S. real property interest. Gain from the disposition of a U.S. real property interest derived by an Argentine enterprise engaged in the international operations of ships or aircraft is not excluded from U.S. taxation under section 897 of the Code by Article 2(2) of an executive agreement between the U.S. and Argentina, concluded under sections 872(b) and 883(a).

Rev. Rul. 90-37

ISSUE

Does the agreement between the United States and Argentina described below exempt gain from the disposition of U.S. real property interests from the tax imposed by section 897 of the Internal Revenue Code?

FACTS

X, a U.S. branch of an Argentine corporation, is engaged in the international operation of ships and aircraft through its offices in the U.S. In 1988, *X* disposed of real property that it had used in its business in a transaction in which *X* realized gain. The property is a U.S. real property interest within the meaning of section 897(c) of the Code.

LAW AND ANALYSIS

Sections 872(b) and 883(a) of the Code exclude from the gross income of a nonresident alien individual and of a foreign corporation, respectively, income derived from the operation of ships, aircraft, and certain railroad rolling stock if the foreign country in which such individual is a resident or such corporation is organized grants an equivalent exemption to U.S. individuals and corporations. The excluded income is exempt from United States taxation under subtitle A of the Code.

These provisions, first enacted as part of the Revenue Act of 1921, 42 Stat. 227, are intended to prevent the double taxation of shipping income of individuals or corporations that operate internationally and to eliminate the difficulties associated with determining the sources of income so earned. H.R. Rept. No. 1435, 80th Cong. 2d Sess. 1-3 (1938); S. Rept. No. 275, 67th Cong., 1st Sess. 14 (1921); see also *M/V Nonsuco, Inc. v. Commissioner*, 234 F.2d 583 (4th Cir. 1956). Reciprocal exemption may be provided by the exchange of notes through formal diplomatic channels. In addition, countries enacting laws

similar to the provisions of sections 872(b) and 883(a) may be treated as granting an equivalent exemption. H.R. Rept. No. 1435.

The legislative history of sections 872(b) and 883(a) of the Code and their predecessors reflects the intent of Congress to exempt from U.S. taxation the shipping profits generated by the international transport of goods and passengers. These provisions were not intended to exempt investment or other non-shipping business income derived by shipping enterprises. See Rev. Rul. 74-170, 1974-1 C.B. 175; Rev. Rul. 274, 1953-2 C.B. 81.

Section 897(a) of the Code requires foreign persons to take into account gain or loss from the disposition of a U.S. real property interest under section 871 in the case of nonresident alien individuals, or under section 882 in the case of foreign corporations, as if the gain or loss were effectively connected with the conduct of a trade or business by the foreign person within the United States. A U.S. real property interest is defined, in general, as an interest in real property in the United States or the U.S. Virgin Islands, or an interest in a domestic corporation that is a U.S. real property holding corporation within the meaning of section 897(c)(2). Gain from the disposition of a U.S. real property interest taxable under section 897 is not exempted by sections 872(b) and 883(a).

By exchange of notes dated December 30, 1987, the U.S. and Argentina concluded an agreement (The "Agreement") based on sections 872(b) and 883(a) of the Code to exclude from taxation in one state the gross income derived by an enterprise of the other state from the international operation of ships or aircraft. 1988-1 C.B. 456. The Agreement also permits Argentina to impose its capital tax on certain assets of Argentine enterprises.

Article 2(1) of the Agreement, relating to gross income derived by an enterprise, applies only to gross income from the international operation of ships or aircraft. Thus, it does not apply to income from the disposition of a U.S. real property interest. Article 2(2) of the Agreement states:

> Capital represented by ships or aircraft operated in international transport and by movable or immovable property pertaining exclusively to the operation of such ships or aircraft shall be taxable only in the Party in which the enterprise that operates such ships or aircraft is subject to tax in accordance with the preceding provisions.

This paragraph refers to a capital tax, and not gain from the disposition of a capital asset. This interpretation is consistent with both the language of the Agreement and the purpose and intent of sections 872(b) and 883(a). Accordingly, neither the income tax nor the capital tax provisions of the Agreement limit the right of the United States to tax gain from the disposition of a U.S. real property interest. Furthermore, sections 872(b) and 883(a) do not provide authority to conclude an executive agreement that modifies the taxation of income taxable pursuant to section 897. See also *United States v. Guy W. Capps, Inc.*, 204 F.2d 655 (4th Cir. 1953); *Swearingen v. United States*, 565 F. Supp. 1019 (D.C. Col. 1983).

HOLDING

Gain realized by *X* from the disposition of a U.S. real property interest is not exempted by Article 2(2) of the Agreement from U.S. taxation under section 897 of the Code. Thus, amounts realized that are taxable pursuant to section 897 are not exempt from United States taxation under any provision of the Agreement.

Subpart D.—Miscellaneous Provisions

Section 897.—Disposition of Investment in United States Real Property

Article 2(2) of an executive agreement between the United States and Argentina, concluded under sections 872(b) and 883, does not exclude from U.S. taxation under section 897 gain from the disposition of a U.S. real property interest realized by an Argentine enterprise engaged in the international operation of ships or aircraft. See Rev. Rul. 90-37, page 141.

26 CFR 1.897-5T: Corporate distributions (temporary).

Whether gain is recognized in certain 332 liquidations. See Rev. Proc. 90-19, page 495.

Part III.—Income From Sources Without the United States
Subpart A.—Foreign Tax Credit

Section 902.—Deemed Paid Credit Where Domestic Corporation Owns 10 Percent or More of Voting Stock of Foreign Corporation

Ct. D. 2047

SUPREME COURT OF THE UNITED STATES
No. 88-1474

United States, Petitioner v. Goodyear Tire and Rubber Company and Affiliates

[493 U.S.]

On Writ of Certiorari to The United States Court of Appeals for The Federal Circuit

December 11, 1989

Syllabus

In 1970 and 1971, Goodyear Tyre and Rubber Company (Great Britain) Limited (Goodyear G.B.), a wholly owned subsidiary of Goodyear Tire and Rubber Company (Goodyear), a domestic corporation, filed income tax returns in, and paid taxes to, the United Kingdom and the Republic of Ireland. It also distributed dividends to Goodyear, its sole shareholder, which Goodyear reported on its federal tax return. Thereafter Goodyear sought an indirect credit for a portion of the foreign taxes paid by Goodyear G.B. as permitted by §902 of the Internal Revenue Code (Code), which limits a domestic parent corporation's credit to the amount of tax paid by the subsidiary attributable to the dividend issued. The credit is calculated by multiplying the total foreign tax paid by that portion of the subsidiary's after-tax "accumulated profits" that is actually issued to the domestic parent in the form of a taxable dividend. After Goodyear G.B. carried back a net loss reported on its 1973 British tax return to offset portions of its 1970 and 1971 income, British taxing authorities recalculated its 1970 and 1971 income and tax liability, and the company received a refund for those years. Pursuant to §905(c) of the Code—which permits redetermination of the foreign

tax credit whenever any tax paid is refunded—the Commissioner of Internal Revenue recalculated the indirect tax credit available to Goodyear for 1970 and 1971 by lowering the foreign taxes paid to reflect the refund. However, he refused to lower accumulated profits for those years to reflect the British tax authorities' redetermination because, applying United States tax principles, Goodyear G.B.'s loss would not have been allowable had the company been a domestic corporation filing a federal tax return. Thus, the Commissioner assessed, and Goodyear paid, tax deficiencies for 1970 and 1971. Goodyear subsequently sought a refund in the Claims Court, which rejected Goodyear's claim that foreign tax law principles govern the calculation of "accumulated profits" in §902's tax credit, finding instead that the purposes underlying §902 favored calculation of "accumulated profits" in accordance with United States tax concepts. The Court of Appeals reversed, holding that the "plain meaning" of §902 required that "accumulated profits" be determined under foreign law. It also held that the congressional purpose underlying §902 to eliminate international double taxation would be defeated if a foreign subsidiary's taxes, but not its "accumulated profits," were calculated under foreign law.

Held: "Accumulated profits," as that term appears in §902's indirect tax credit, are to be calculated in accordance with domestic tax principles.

(a) Section 902's text does not resolve how "accumulated profits" are to be calculated, since it relates such profits both to the foreign tax paid by the subsidiary, calculated in accordance with foreign law, and to the dividend issued by the subsidiary, calculated in accordance with domestic law.

(b) No definitional approach to "accumulated profits" uniformly and unqualifiedly satisfies the indirect credit's dual congressional purposes, as clearly demonstrated by the credit's history, of protecting a domestic parent from double taxation of its income and treating foreign branches and foreign subsidiaries alike in terms of the tax credits they generate for their domestic companies. Goodyear correctly claims that calculating such profits according to domestic tax principles can result in situations in which §902's statutory goal of avoiding double taxation will be deserved. However, as the Government contends, defining the profits in terms of foreign tax principles can unfairly advantage domestic companies that operate through foreign subsidiaries over those that operate through unincorporated branches.

(c) The Government's interpretation of "accumulated profits" is more faithful to congressional intent. The risk of double taxation is less substantial than the risk of unequal treatment. Goodyear offers no basis for its suggestion that double taxation—which can result only when a dividend is sourced to a year in which domestic tax concepts recognize little or no income and yet a subsidiary pays substantial foreign tax—commonly occurs. On the other hand, Goodyear's approach leads to unequal tax treatment of subsidiaries and branches whenever the foreign taxing authority calculates income more or less generously than the United States, a result that is difficult to square with the express congressional purpose of ensuring tax parity between corporations that operate through foreign subsidiaries and those that operate through foreign branches. The Government's approach is also supported by administrative interpretations of §902 and by the statutory canon that tax provisions should generally be read to incorporate domestic tax concepts absent a clear congressional expression that foreign concepts control, *Biddle* v. *Commissioner*, 302 U.S. 573, 578.

856 F. 2d 170, reversed and remanded.

Marshall, J., delivered the opinion for a unanimous Court.

Justice Marshall delivered the opinion of the Court.

In this case, we must decide whether "accumulated profits" in the indirect tax credit provision of the Internal Revenue Code of 1954, 26 U.S.C. §902 (1970 ed.), are to be measured in accordance with United States or foreign tax principles. We conclude that "accumulated profits" are to be measured in accordance with United States principles.

I

Goodyear Tyre and Rubber Company (Great Britain) Limited (Goodyear G.B.) is a wholly owned subsidiary of Goodyear Tire and Rubber Company, a domestic corporation (Goodyear). Goodyear brought this suit seeking a refund of federal income taxes collected for the years 1970 and 1971. During those years, Goodyear G.B. filed income tax returns in, and paid taxes to, the United Kingdom and the Republic of Ireland. Goodyear G.B. also distributed dividends to Goodyear, its sole shareholder. Goodyear reported these dividends on its federal tax return, as required by 26 U.S.C. §§301, 316 (1970 ed.). Goodyear thereafter sought credit for a portion of the foreign taxes paid by Goodyear G.B. in the amount specified in §902.[1]

Section 902 provides a parent of a foreign subsidiary with an "indirect" or "deemed paid" credit on its domestic income tax return to reflect foreign taxes paid by its subsidiary. The credit protects domestic corporations that operate through foreign subsidiaries from double taxation of the same income; taxation first by the foreign jurisdiction, when the income is earned by the subsidiary, and second by the United States, when the

[1]Section 902(a) provides:

"For purposes of this subpart, a domestic corporation which owns at least 10 percent of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall—

(1) to the extent such dividends are paid by such foreign corporation out of accumulated profits (as defined in subsection (c)(1)(A)) of a year for which such foreign corporation is not a less developed country corporation, be deemed to have paid the same proportion of any income, war profits, or excess profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States on or with respect to such accumulated profits, which the amount of such dividends (determined without regard to section 78) bears to the amount of such accumulated profits in excess of such income, war profits, and excess profits taxes (other than those deemed paid). . . ."

income is received as a dividend by the parent. In some circumstances, a foreign subsidiary may choose to distribute only a portion of its available profit as a dividend to its domestic parent. For that reason, a domestic parent cannot automatically claim credit for all foreign taxes paid by its subsidiary: §902 limits a domestic parent's credit to the amount of tax paid by the subsidiary attributable to the dividend issued. The foreign tax deemed paid by the domestic parent is calculated by multiplying the total foreign tax paid (T) by that portion of the subsidiary's after-tax accumulated profits (AP-T) that is actually issued to the domestic parent in the form of a taxable dividend (D).[2]

In 1973, Goodyear G.B. reported a net loss on its British tax return and carried back that loss to offset substantial portions of its 1970 and 1971 income. Based on the 1973 carried-back losses, British taxing authorities recalculated Goodyear G.B.'s income and tax liability for the years 1970 and 1971. Goodyear G.B. thereafter received a refund of a substantial portion of its 1970 and 1971 foreign tax payments.

In response to the refunds, and pursuant to §905(c) of the Code which permits redetermination of the foreign tax credit whenever "any tax paid is refunded in whole or in part," the Commissioner of Internal Revenue recalculated the indirect tax credit available to Goodyear for the tax years 1970 and 1971. The Commissioner lowered the foreign taxes paid (T) to reflect the refund. He refused, however, to lower accumulated profits (AP) for those years to reflect British tax authorities' redetermination of Goodyear G.B.'s income. The deductions that created, for British tax purposes, the 1973 loss would not have been allowable in the computation of United States income tax if Goodyear G.B. had been a United States corporation filing a United States return. See App. 19-29 (Stipulation of Facts). In the Commissioner's view, accumulated profits are to be calculated in accordance with United States tax principles; accordingly, the Commissioner regarded Goodyear G.B.'s 1970 and 1971 accumulated profits as unaffected by the deductions allowed under British law.

In view of the reduced amount of Goodyear's tax deemed paid, the Commissioner assessed substantial tax deficiencies for the tax years 1970 and 1971. Goodyear paid the deficiencies and, following the IRS's denial of its administrative refund claim, brought this action in the United States Claims Court, averring that foreign tax law principles govern the calculation of "accumulated profits" in §902's tax credit. Calculating "accumulated profits" in accordance with British tax law principles, Goodyear maintained that Goodyear G.B.'s after-tax accumulated profits for 1970 and 1971 were insufficient to cover the dividends paid in those years. In such a circumstance, §902 requires that, for the purpose of computing the indirect credit, the excess of the dividend be deemed paid out of the after-tax accumulated profits of the preceding year. If in that year the remaining portion of the dividend exceeds the after-tax accumulated profits, the remainder of the dividend is allocated or "sourced" to the next most recent year, until the dividend is exhausted.[3] Thus, Goodyear argued that the dividends it received from Goodyear G.B. in 1970 and 1971 should have been sourced to prior tax years, 1968 and 1969, until Goodyear G.B.'s after-tax accumulated profits covered the dividends. Through this sourcing mechanism, Goodyear would, in computing its domestic tax liability for the dividends issued by Goodyear G.B., receive credit for a portion of the foreign taxes paid by Goodyear G.B. in 1968 and 1969. Because Goodyear G.B. paid substantial foreign taxes in those tax years, allocation of the dividend to those years would yield a tax deemed paid by Goodyear in excess of £1,000,000, over four times greater than the tax the Commissioner deemed paid. If the term "accumulated profits" is defined in accordance with domestic tax principles, as the Commissioner advocated, the dividends issued in 1970 and 1971 are fully exhausted by the accumulated profits of those years, resulting in a tax deemed paid of £247,124.

The Claims Court rejected Goodyear's claim. 14 Cl. Ct. 23 (1987). Viewing the statutory definition of "accumulated profits" in §902(c)(1)(A) as inconclusive, 14 Cl. Ct., at 28-29, the court turned to the purposes underlying §902 and found that they favored calculation of "accumulated profits" in accordance with United States tax concepts, *id.*, at 29-31. The Court of Appeals for the Federal Circuit reversed. 856 F. 2d 170 (1988). The court held that the "plain meaning" of §902 "requires [accumulated profits] to be determined under foreign law." 856 F. 2d, at 172. The court also held that the fundamental congressional purpose underlying §902, " 'elimination of international double taxation,'" *ibid.* (quoting *H. H. Robertson Co.* v. *Commissioner*, 59 T.C. 53, 74 (1972), aff'd, 500 F. 2d 1399 (CA3 1974), would be defeated if the taxes paid by a foreign subsidiary, but not its accumulated profits, were calculated in terms of foreign law. 856 F. 2d, at 172.

The Court of Appeals' decision has important consequences for the calculation of the indirect tax credit of domestic parents that have received dividends from their subsidiaries abroad. To clarify the operation of the §902 credit in the tax years to which it applies,[4] we granted certiorari, 490 U.S. (1989), and now reverse.

II

Our starting point, as in all cases involving statutory interpretation, "must be the language employed by

[2]The formula for calculating the §902 credit is as follows:

$$\text{Credit} = \text{Foreign Taxes Paid (T)} \times \frac{\text{Dividends (D)}}{\text{Accumulated Profits (AP) minus Foreign Taxes (T)}}$$

[3]The operation of this sourcing principle is described in *General Foods Corp.* v. *Commissioner*, 4 T.C. 209, 215 (1944).

[4]Calculation of the indirect credit for tax years beginning after 1986 is governed by the amended version of §902 established by the Tax Reform Act of 1986, 100 Stat. 2528, 26 U.S.C. §902 (1982 ed., Supp. IV). The amended version substantially overhauls the method of calculating the credit and removes the controversy regarding the definition of "accumulated profits." The current version of §902(c)(1) replaces "accumulated profits" with "undistributed earnings," which are defined as the "earnings and profits of the foreign corporation (computed in accordance with sections 964 and 986)." Section 964(a) in turn provides that "the earnings and profits of any foreign corporation. . .shall be determined according to rules substantially similar to those applicable to domestic corporations." 26 U.S.C. §964(a) (1982 ed.).

Congress." *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 337 (1979). We find that the text of §902 does not resolve whether "accumulated profits" are to be calculated in accordance with foreign or domestic tax concepts.

It is true, as the Court of Appeals emphasized, that §§902(a)(1) and 902(c)(1)(A) link "accumulated profits" to the foreign tax imposed on the subsidiary. The link is forged by describing the foreign tax as that tax imposed "on or with respect to" accumulated profits. The provisions also, however, link "accumulated profits" to "dividends" by describing "accumulated profits" as the pool from which the "dividends" are issued. Section 316(a), in turn, makes clear that domestic principles control whether a payment is a "dividend" subject to domestic tax. On the basis of this link, a leading treatise has concluded that "[a]ccumulated profits of the foreign corporation. . .are, in general, equated with earnings and profits of the foreign corporation and are determined in accordance with domestic law principles." B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders ¶17.11, p. 17-44 (5th ed. 1987) ("Adoption of these principles has the virtue of correlating the denominator of the §902 computation with the definition of dividends (the numerator), thus avoiding the possible distortions that could arise if different definitional approaches were used for the numerator and denominator of the §902 fraction"). Because §902 relates "accumulated profits" both to the foreign tax paid by the subsidiary, calculated in accordance with foreign law, and to the dividend issued by the subsidiary, calculated in accordance with domestic law, we are unpersuaded that the statutory language is dispositive. We must therefore look beyond the statute's language to the legislative history, purposes, and operation of the indirect tax credit.

III

A

The history of the indirect credit clearly demonstrates that the credit was intended to protect a domestic parent from double taxation of its income. Congress first established the indirect tax credit in §240(c) of the Revenue Act of 1918, 40 Stat. 1082, permitting a domestic parent to receive a credit for a portion of the foreign taxes paid by its subsidiary during the year in which the subsidiary issued a dividend to the parent. This Court subsequently described the purpose of §240(c) as protection against double taxation. *American Chicle Co.* v. *United States*, 316 U.S. 450, 452 (1942); see also Bittker & Eustice, at ¶17.11, p. 17-40.

The legislative history of the indirect credit also clearly reflects an intent to equalize treatment between domestic corporations that operate through foreign subsidiaries and those that operate through unincorporated foreign branches. In §238(e) of the Revenue Act of 1921, 42 Stat. 259, Congress amended §240(c) to permit a domestic corporation to claim credit for taxes its subsidiary paid in years other than those in which the dividend was issued. Prior to the amendment, a domestic corporation could not receive credit for foreign taxes paid on distributed income of its subsidiary issued the dividend out of income earned in prior years, see 316 U.S., at 453, because §240(c) limited the credit to taxes paid by the subsidiary "during the taxable year" in which the dividend was issued. The amendment corrected this deficiency by relating the credit to the accumulated profits out of which the dividends were paid.

In defending the amended version of the indirect credit, one sponsor described the purpose of the credit as securing, for domestic corporations that receive income in the form of dividends from foreign subsidiaries, the same sort of deduction available to domestic corporations that receive income from foreign branches. 61 Cong. Rec. 7184 (1921).[5] This goal of equalized treatment is reflected as well in testimony regarding the amendment before the Senate Committee on Finance, in which a spokesperson for the Department of the Treasury described the proposal as intended "to give this American corporation about the same credit as if conducting a branch." Hearings on H.R. 8245 before the Senate Committee on Finance, 67th Cong., 1st Sess., pt. 2, p. 389 (1921). More recently, the Senate Report on the 1962 amendments to the indirect credit confirms Congress' intent to treat foreign branches and foreign subsidiaries alike in terms of the tax credits they generate for their domestic companies. See S. Rep. No. 1881, 87th Cong., 2d Sess., 66-67 (1962).[6]

B

Given these purposes, we now turn to the operation of the indirect tax credit. Goodyear contends that the failure to calculate accumulated profits in terms of foreign law subjects domestic corporations that receive dividends from their foreign subsidiaries to double taxation. This undesirable result occurs, in Goodyear's view, because calculation of accumulated profits in accordance with domestic principles may disconnect the relationship in §902's formula between accumulated profits and the foreign tax paid by the subsidiary. A subsidiary incurs foreign tax liability in proportion to its foreign defined-income. To recover foreign taxes paid by its subsidiary, a domestic parent's

[5]Senator Smoot stated:

"[A] foreign subsidiary is much like a foreign branch of an American corporation. If the American corporation owned a foreign branch, it would include the earnings or profits of such branch in its total income, but it would also be entitled to deduct from the tax based upon such income any income or profits taxes paid to foreign countries by the branch in question. Without special legislation, however, no credit can be obtained where the branch is incorporated under foreign laws."

[6]The 1962 amendment addresses a tax preference that results if a domestic parent is credited with foreign taxes paid on subsidiary income that is used to satisfy the subsidiary's foreign tax obligations. In such a circumstance, the parent receives credit for taxes paid on undistributed income. This Court sought to eliminate this tax advantage in *American Chicle Co.* v. *United States*, 316 U.S. 450, 452 (1942), by including in the §902 credit only those taxes paid on a subsidiary's after-tax income. The 1962 amendment addressed the problem differently, permitting a domestic parent to include all foreign taxes paid in its §902 calculation but also requiring the parent to treat such taxes as a deemed dividend from its subsidiary. The amendment thus requires domestic parents to "gross up" the dividend income they receive by the amount of the foreign taxes attributable to such income. See S. Rep. No. 1881, 87th Cong., 2d Sess., 69 (1962). The Senate Report, describing the purpose of the amendment as removing an "unjustified tax advantage" for domestic parents, illustrates how foreign subsidiaries and foreign branches are treated unequally absent the "grossing up" requirement, even under the *American Chicle* rule. *Id.*, at 66-67.

dividend must be allocated or sourced to years in which its subsidiary paid foreign tax. If, however, accumulated profits are defined in domestic terms, the dividends of a domestic parent may be allocated to years in which the subsidiary paid little or no tax. In such a scenario, the parent may not be credited with foreign taxes paid by its subsidiary. To avoid this mismatching of accumulated profits and foreign tax, Goodyear contends that accumulated profits should be determined in accordance with the same principles that govern the imposition of the tax: those found in foreign law.

The Government contests Goodyear's characterization of this case as one of "double taxation." In the Government's view, the dividends received by Goodyear should not be allocated to prior years because to do so would permit Goodyear to avoid taxation altogether on domestically defined income that its subsidiary earned in 1970 and 1971. Under domestic rules, Goodyear G.B. earned sufficient income in 1970 and 1971 to cover the dividends it issued to Goodyear in those years. That British taxing authorities recognized little income in those years should not, in the Government's view, prevent the United States from recognizing the substantial income attributable to those years under domestic rules. According to the Government, the foreign tax paid in 1968 and 1969 by Goodyear G.B.—the years to which Goodyear seeks to source its dividends—relates to income that Goodyear G.B. chose not to distribute during those years as dividends to Goodyear. To credit Goodyear with taxes paid on undistributed income, the Government concludes, would be inequitable because it would provide domestic parents that operate through foreign subsidiaries favorable treatment vis-à-vis domestic corporations that use foreign branches.

Goodyear attempts to avoid the force of the Government's analysis by exploring hypothetical situations in which the calculation of accumulated profits in accordance with domestic rules presents a more plausible claim of double taxation than does this case. For example, if a subsidiary earns an equal amount of income under foreign and domestic rules, but those rules regard the income as being earned in different years, the domestic parent would be credited with a lower portion of the tax paid by the subsidiary if domestic timing rules govern. This result appears anomalous because the same credit should be available where foreign and domestic tax principles recognize equal amounts of income and the amount of tax paid remains constant. The effect of the divergence in foreign and domestic tax principles is particularly clear when a subsidiary pays a substantial foreign tax in a given year and the amount of income recognized under domestic rules in that year is zero. In such a circumstance, *none* of the tax paid by the subsidiary can be credited to the parent because a dividend cannot be sourced to a year in which there are no accumulated profits.

Goodyear's hypotheticals persuade us that if accumulated profits are calculated according to domestic tax principles, situations can arise in which §902's statutory goal of avoiding double taxation will be deserved. Equally persuasive, however, is the Government's claim that defining accumulated profits in terms of foreign tax principles can unfairly advantage domestic parents that operate through foreign subsidiaries over companies operating through unincorporated branches. Thus, no definitional approach to "accumulated profits" uniformly and unqualifiedly satisfies the dual purposes underlying the indirect credit.

C

We nonetheless believe that the Government's interpretation of "accumulated profits" is more faithful to congressional intent. Our view is informed first and most significantly by our assessment that the risk of double taxation outlined by Goodyear is less substantial than the risk of unequal treatment cited by the Government. Defining "accumulated profits" in accordance with domestic tax concepts results in double taxation only when a dividend is sourced to a year in which domestic tax concepts recognize little or no income and yet a subsidiary pays substantial foreign tax. Goodyear offers no basis for the suggestion that such mismatching commonly occurs.

Goodyear's approach, on the other hand, leads to unequal tax treatment of subsidiaries and branches whenever the foreign taxing authority calculates income more or less generously than the United States. A domestic corporation must pay tax on all income of a foreign branch that is recognized under domestic law. Under Goodyear's interpretation, a domestic corporation may in some cases receive credit for taxes paid on income that, under domestic rules, the parent never received. This result is difficult to square with the express congressional purpose of ensuring tax parity between domestic corporations that operate through foreign subsidiaries and those that operate through foreign branches.

The Government's approach is also supported by administrative interpretations of §902. In defining the credits available against foreign tax under the predecessor to §902, the Commissioner stated that "[i]t is important in establishing the amount of the accumulated profits that it be based as a fundamental principle upon all income of the foreign corporation available for distribution to its shareholders *whether such profits be taxable by the foreign country or not.*" I.T. 2676, XII-1 Cum. Bull. 48, 50 (1933) (emphasis added). The Commissioner's approach requires a domestic assessment of income for the purposes of calculating accumulated profits. The Commissioner's position is reflected as well in a formal regulation promulgated by the Treasury in 1965, Treas. Reg. §.1902-3(c)(1), 26 CFR §1.902-3(c)(1) (1972), which defines "accumulated profits" under §902(a)(1) as "the sum of [t]he earnings and profits of [the foreign subsidiary] for such years, and [t]he foreign income taxes imposed on or with respect to the gains, profits, and income to which such earnings and profits are attributable." Defining a subsidiary's "accumulated profits" as its "earnings and profits" reflects an intent to calculate accumulated profits according to domestic principles, because "earnings and profits" in this context is a domestic tax concept.

Lastly, we find support for the Government's position in the statutory canon adopted in *Biddle* v. *Commissioner*, 302 U.S. 573, 578 (1938), that tax provisions should generally be read to incorporate domestic tax concepts absent a clear congressional expression that foreign concepts con-

trol. This canon has particularly strong application here where a contrary interpretation would leave an important statutory goal regarding equal tax treatment of foreign subsidiaries and foreign branches to the varying tax policies of foreign tax authorities.

IV

"Accumulated profits," as that term appears in §902's indirect tax credit, should be calculated in accordance with domestic tax principles. The judgment of the Court of Appeals is therefore reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

Section 904.—Limitation on Credit

26 CFR 1.904-4(d): High withholding tax interest.

Two safe harbors are provided for complying with the loan loss reserve reporting requirement of the Revenue Reconciliation Act of 1989 which if satisfied allows taxpayers to exclude certain interest on qualified loans from the separate foreign tax credit limitation for high withholding tax interest. See Rev. Proc. 90-14, page 473.

Subpart F.—Controlled Foreign Corporations

Section 959.—Exclusion From Gross Income Of Previously Taxed Earnings and Profits

26 CFR 1.959-1: Exclusion from gross income of United States persons of previously taxed earnings and profits.
(Also Section 1248; 1.1248-1.)

Effect on Section 1248 computations of dividends paid in year of sale. Earnings and profits of a controlled foreign corporation are decreased by amounts previously included in gross income of the transferor shareholder as a dividend under section 1248 of the Code at the time of the actual distribution of the section 951(a)(1)A) amount attributable to such section 1248 dividend. Rev. Rul. 71-388 modified and Rev. Rul. 83-182 obsoleted.

Rev. Rul. 90-31

ISSUE

Are the earnings and profits of a controlled foreign corporation decreased by the amount of gain from the sale of its stock that is treated as a dividend under section 1248 of the Internal Revenue Code of 1986?

LAW AND ANALYSIS

Rev. Rul. 71-388, 1971-2 C.B. 314, holds, in part, that the earnings and profits of a controlled foreign corporation are not decreased by the amount of gain from the sale of its stock that is treated as a dividend under section 1248 of the Code. Rev. Rul. 83-182, 1983-2 C.B. 149, suspends that part of Rev. Rul. 71-388, pending resolution of the issue.

The issue has now been resolved by amendments to section 959 of the Code. Section 959(e) was added by section 133(b)(1) of the Tax Reform Act of 1984, 1984-3 (Vol. 1) C.B. 175, 176. Section 959(e) provides, in part, that any amount included in the gross income of any person as a dividend by reason of subsection 1248(a) or (f) will be treated for purposes of section 959(a) as an amount included in the gross income of such person under section 951(a)(1)(A). H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 960 (1984), 1984-3 (Vol. 2) C.B. 214. Section 959(a) provides that earnings and profits for a taxable year of a foreign corporation attributable to amounts included in the gross income of a U.S. shareholder under section 951(a) will not be included again in gross income when such amounts are distributed or would otherwise be included in gross income under section 951(a)(1)(B). Section 1226(b) of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 476, 477, amended section 959(d) to clarify that distributions excluded from gross income under section 959(a) will immediately reduce earnings and profits. H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. 629 (1986), 1986-3 (Vol. 4) C.B. 629.

Thus, if a transferor shareholder includes an amount in gross income as a dividend under section 1248 of the Code, the earnings and profits of the controlled foreign corporation are not reduced at the time of the recognition of the dividend amount. Instead, under section 959(e), an account under section 951(a)(1)(A) in the amount of the dividend is established on behalf of the transferee shareholder as if that amount had been included in gross income under section 951(a)(1)(A). *See* section 1.959-1(d) of the Income Tax regulations. When an amount is actually distributed to the transferee shareholder, the amounts previously taxed under section 951(a)(1)(A) are deemed to be distributed first. The amount previously taxed to the transferor shareholder as a dividend under section 1248 is treated as a section 951(a)(1)(A) amount and, thus, is not taxed again to the transferee shareholder when actually distributed. (The transferee shareholder, however, must satisfy the district director that the transferee shareholder is eligible for an exclusion from gross income under section 959(a). *See* section 1.959-1(d).) The earnings and profits of the controlled foreign corporation are reduced under section 959(d) at the time of the actual distribution of the section 951(a)(1)(A) amount attributable to the section 1248 dividend. H.R. Rep. No. 432, Part 2, 98th Cong. 2d Sess. 1327 (1984).

The transferor shareholder is allowed a foreign tax credit under section 902 of the Code if it is a domestic corporation that, on the date of the sale or exchange, directly owns at least 10 percent of the voting stock of the foreign corporation. The credit is for foreign taxes paid or accrued with respect to earnings and profits to the extent such earnings and profits result in the recharacterization of gain realized by the transferor shareholder on the transfer as a dividend under section 1248. *See* section 1.1248-1(d) of the regulations. The transferee shareholder is not allowed a foreign tax credit for foreign taxes paid or accrued with respect to earnings that result in the recharacterization of the transferor's gain as a dividend (whether or not such foreign taxes were deemed paid by the transferor under section 902).

HOLDING

Earnings and profits of a controlled foreign corporation are decreased by amounts previously included in gross income of the transferor shareholder as a dividend under section 1248 of the Code at the time of the actual distribution of the section 951(a)(1)(A) amount attributable to

such section 1248 dividend. A transferee shareholder is not allowed a foreign tax credit at the time of such actual distribution for foreign taxes paid or accrued with respect to earnings that result in the recharacterization of the transferor's gain as a dividend (whether or not such foreign taxes were deemed paid by the transferor under section 902).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 71-388 is modified. Rev. Rul. 83-182 is obsolete.

Section 964.—Miscellaneous Provisions

26 CFR 1.964-1T: Special rules for computing earnings and profits of controlled foreign corporations in taxable years beginning after December 31, 1986 (temporary).

T.D. 8283

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Earnings and Profits of Controlled Foreign Corporations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary Income Tax Regulations relating to the election or adoption of tax accounting methods affecting the computation of earnings and profits of a controlled foreign corporation in post-1986 taxable years. Changes to the applicable law were made by the Tax Reform Act of 1986. The text of the temoprary regulations set forth in this document also serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in *** [INTL-40-89, page 679, this Bulletin].

DATES: These temporary regulations are effective for taxable years of a controlled foreign corporation beginning after December 31, 1986.

SUPPLEMENTARY INFORMATION:

Background

This document contains temporary Income Tax Regulations (26 CFR Part 1) under section 964 of the Internal Revenue Code of 1986.

Need for Temporary Regulations

The proper application of section 964 is dependent upon the Internal Revenue Service's detailed specification of the manner in which the requirements of the statute will be administered. These regulations are necessary to provide taxpayers with immediate guidance in the application of changes made by sections 1202(a) and 1261 of the Tax Reform Act of 1986 (Pub. L. 99-514, 100 Stat. 2085). [1986-1 C.B. (Vol. 1) 1]. Therefore, good cause is found to dispense with the notice and public procedure requirements of 5 U.S.C. §553(b) and the delayed effective date requirement of 5 U.S.C. §553(d).

Explanation of Provisions

The temporary regulations amend the regulations under section 964(a) by adding special rules applicable in computing the earnings and profits of a controlled foreign corporation (CFC) for taxable years beginning after December 31, 1986. Section 1.964-1T(g)(1) provides that the earnings and profits of a CFC shall be computed in its functional currency (as determined under section 985). In addition, this paragraph clarifies that §1.964-1(d), (e), and (f) apply only for taxable years beginning before January 1, 1987.

Section 1.964-1T(g)(2) states that for taxable years beginning after December 31, 1988, tax accounting elections are required when a CFC's earnings and profits first become relevant for United States income tax purposes. The definition in the current regulations of a significant event is thus prospectively amended to provide an illustrative, rather than exclusive, list. Generally, as under the existing regulations, the adoption or election of a method of accounting must be made within 180 days after the close of the CFC's first tax year in which a significant event occurs.

Section 1.964-1T(g)(3) provides that the failure to make timely elections will be treated as the affirmative adoption of any permissible methods of accounting (not requiring elections) that are reflected in the CFC's books. As under the existing regulations, the Commissioner may approve late elections if reasonable cause for missing a filing deadline is shown; however, under the new regulations mere inadvertence will not suffice.

A similar rule is provided in §1.964-1T(g)(4) for a minority United States shareholder who must compute a CFC's earnings and profits before accounting elections are made (*e.g.*, in order to compute the amount of the gain on the minority shareholder's sale of CFC stock treated as a dividend under section 1248). This is consistent with the current rule that only the CFC itself or its controlling United States shareholders have the power to make accounting elections. The Service is interested in receiving comments on the extent to which the regulations should provide for tax accounting elections by shareholders of a noncontrolled foreign corporation.

Section 1.964-1T(g)(5) clarifies that earnings and profits of a CFC in post-1986 taxable years must be computed consistently under the rules of sections 964(a) and 986(b) for all federal income tax purposes. In addition, this paragraph generally provides that pre-1987 elections are binding in post-1986 taxable years unless the Commissioner consents to a change.

Section 1.964-1T(g)(6) provides examples illustrating the operation of §1.964-1T(g). The Service solicits comments on other appropriate changes to §1.964-1.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

PART 1—INCOME TAX REGULATIONS

Paragraph 1. The authority for part 1 continues to read in part:

Authority: 26 U.S.C. 7805. ***Section 1.964-1T also issued under 26 U.S.C. 964.***

Par. 2. A new §1.964-1T is added immediately following §1.964-1 to read as follows:

§1.964-1T(a) through (f) [Reserved].

§1.964-1T Special rules for computing earnings and profits of controlled foreign corporations in taxable years beginning after December 31, 1986 (Temporary).

(g)(1) *Earnings and profits computed in functional currency*—(i) *Rule.* For taxable years of a controlled foreign corporation (within the meaning of section 957) beginning after December 31, 1986, earnings and profits shall be computed in the controlled foreign corporation's functional currency (determined under section 985 and the regulations thereunder) in accordance with §1.964-1 as modified by this paragraph (g). Accordingly, §1.964-1(d), (e), and (f) and (to the extent inconsistent with this pargraph (g)) §1.964-1(c) do not apply for taxable years of a controlled foreign corporation beginning after December 31, 1986. For purposes of this section, the term "earnings and profits" includes a deficit in earnings and profits.

(ii) *Cross reference.* In the case of a controlled foreign corporation with a functional currency other than the United States dollar (dollar), see sections 986(b) and 989(b) for rules regarding the time and manner of translating distributions or inclusions of the controlled foreign corporation's earnings and profits into dollars.

(2) *Election required when first significant.* Tax accounting methods or elections may be adopted or made by, or on behalf of, a controlled foreign corporation in the manner prescribed by the Code and regulations no later than 180 days after the close of the first taxable year of the controlled foreign corporation in which the computation of its earnings and profits is significant for United States income tax purposes with respect to its controlling United States shareholders (as defined in §1.964-1(c)(5)). For taxable years of a controlled foreign corporation beginning before January 1, 1989, only the events listed in §1.964-1(c)(6) are considered to cause a controlled foreign corporation's earnings and profits to have United States tax significance. For taxable years of a controlled foreign corporation beginning after December 31, 1988, events that cause a controlled foreign corporation's earnings and profits to have United States tax significance include, without limitation—

(i) The events listed in §1.964-1(c)(6),

(ii) A distribution from the controlled foreign corporation to its shareholders with respect to their stock,

(iii) Any event making the controlled foreign corporation subject to tax under section 882,

(iv) An election by the controlled foreign corporation's controlling United States shareholders to use the tax book value method of allocating interest expense under section 864(e)(4), and

(v) A sale or exchange of the controlled foreign corporation's stock by the controlled United States shareholders.

The filing of the information return required by section 6038 shall not itself constitute a significant event.

(3) *Effect of failure to make required election.* If an accounting method or election is not timely adopted or made by, or on behalf of, a controlled foreign corporation, and such failure is not shown to the satisfaction of the Commissioner to be due to reasonable cause under §1.964-1(c)(6), earnings and profits shall be computed in accordance with this section. Such computation shall be made as if no elections had been made and any permissible accounting methods not requiring an election and reflected in the books of account regularly maintained by the controlled foreign corporation for the purpose of accounting to its shareholders had been adopted. Thereafter, any change in a particular accounting method or methods may be made by, or on behalf of, the controlled foreign corporation only with the Commissioner's consent.

(4) *Computation of earnings and profits by a minority shareholder prior to majority election or significant event.* A minority United States shareholder (as defined in section 951(b)) of a controlled foreign corporation may be required to compute a controlled foreign corporation's earnings and profits before the controlled foreign corporation or its controlling United States shareholders make, or are required under this section to make, an election or adopt a method of accounting for United States tax purposes. In such a case, the minority United States shareholder must compute earnings and profits in accordance with this section. Such computation shall be made as if no elections had been made and any permissible accounting methods not requiring an election and reflected in the books of account regularly maintained by the controlled foreign corporation for the purpose of accounting to its shareholders had been adopted. However, a later, properly filed, and timely election or adoption of method by, or on behalf of, the controlled foreign corporation shall not be treated as a change in accounting method.

(5) *Binding effect.* For taxable years beginning after December 31, 1986, except as otherwise provided in the Code or regulations, earnings and profits of a controlled foreign corporation shall be computed consistently under the rules of sections 964(a) and 986(b) for all federal income tax purposes. An election or adoption of a method of accounting for United States tax purposes by a controlled foreign corporation, or on its behalf pursuant to §1.964-1(c) or any other provision of the regulations (*e.g.*, §1.985-2(c)(3)), shall bind both the controlled foreign corporation and its United States shareholders as to the computation of the controlled foreign corporation's earnings and profits under section 964(a) for the year of the election or adoption and in subsequent taxable years unless the Commissioner consents to a change. The preceding sentence shall apply regardless of—

(i) Whether the election or adoption of a method of accounting was made in a pre-1987 or a post-1986 taxable year;

(ii) Whether the controlled foreign corporation was a controlled foreign corporation at the time of the election or adoption of method;

(iii) When ownership was acquired; or

(iv) Whether the United States shareholder received the written notice required by §1.964-1(c)(3).

Adjustments to the appropriate separate category (as defined in §1.904-5(a)(1)) of earnings and profits and income of the controlled foreign corporation shall be required using the principles of sectin 481 to prevent any duplication or omission of amounts attributable to previous years that would otherwise result from any such election or adoption.

(6) *Examples.* The following examples illustrate the rules of this section.

Example (1)—(i) *P*, a calendar year domestic corporation, owns all of the outstanding stock of *FX*, a calendar year controlled foreign corporation. None of the significant events specified in §1.964-1(c)(6) or this section has occurred. In addition, neither *P* nor *FX* has ever made or adopted, or been required to make or adopt, an election or method of accounting for United States tax purposes with respect to *FX*. On June 1, 1990, *FX* makes a distribution to *P*. *FX* does not act to make any election or adopt a method of accounting for United States tax purposes.

(ii) *P* must compute *FX*'s earnings and profits in order to determine if any portion of the distribution is taxable as a dividend and to determine *P*'s foreign tax credit on such portion under section 902. *P* must satisfy the requirements of §1.964-1(c)(3) and file the written statement and notice described therein within 180 days after the close of *FX*'s 1990 taxable year in order to make an election or to adopt a method of accounting on behalf of *FX*. Any such election or adoption will govern the computation of earnings and profits of *FX* for all federal income tax purposes (including, *e.g.*, the determination of foreign tax credits on subpart F inclusions) in 1990 and subsequent taxable years unless the Commissioner consents to a change.

(iii) If *P* fails to satisfy the regulatory requirements in a timely manner and such failure is not shown to the satisfaction of the Commissioner to be due to reasonable cause, the earnings and profits of *FX* shall be computed as if no elections were made and any permissible methods of accounting not requiring an election and reflected in its books were adopted. Any subsequent attempt by *FX* or *P* to change an accounting method shall be effective only if the Commissioner consents to the change.

Example (2)—(i) The facts are the same as in *Example (1)*, except that *P* elects to allocate its interest expense under section 864(e)(4) for its 1989 taxable year under the tax book value method of §1.861-12T(c) of the Temporary Income Tax Regulations.

(ii) *P* must compute the earnings and profits of *FX* in order to determine the adjustment to *P*'s basis in the stock of *FX* for *P*'s 1989 taxable year. *P* must satisfy the requirements of §1.964-1(c)(3) and file the written statement and notice described therein within 180 days after the close of *FX*'s 1989 taxable year in order to make an election or to adopt a method of accounting on behalf of *FX*. Any such election or adoption will govern the computation of *FX*'s earnings and profits in 1989 and subsequent taxable years for all federal income tax purposes (including, *e.g.*, the characterization of the June 1, 1990, distribution and the determination of *P*'s foreign tax credit, if any, with respect thereto) unless the Commissioner consents to a change.

(iii) If *P* fails to satisfy the regulatory requirements in a timely manner and such failure is not shown to the satisfaction of the Commissioner to be due to reasonable cause, the earnings and profits of *FX* shall be computed as if no elections were made and any permissible methods of accounting not requiring an election and reflected in its books were adopted. Any subsequent attempt by *FX* or *P* to change an accounting method shall be effective only if the Commissioner consents to the change.

Example (3)—(i) The facts are the same as in *Example (2)*, except that *P* elects to allocate its interest expense under section 864(e)(4) for its 1988 taxable year under the tax book value method of §1.861-12T(c) of the Temporary Income Tax Regulations.

(ii) *P* must compute the earnings and profits of *FX* in order to determine the adjustment to *P*'s basis in the stock of *FX* for *P*'s 1988 taxable year. *P* must satisfy the requirements of §1.964-1(c)(3) and file the written statement and notice described therein within 180 days after the close of *FX*'s 1988 taxable year in order to make an election or to adopt a method of accounting on behalf of *FX*. Any such election or adoption will govern the computation of *FX*'s earnings and profits in 1988 and subsequent taxable years for all federal income tax purposes (including, *e.g.*, *P*'s basis adjustment for purposes of section 864(e)(4) in 1989 and the characterization of the June 1, 1990, distribution and the determination of *P*'s foreign tax credit, if any, with respect thereto) unless the Commissioner consents to a change.

(iii) If *P* fals to satisfy the regulatory requirements in a timely manner and such failure is not shown to the satisfaction of the Commissioner to be due to reasonable cause, the earnings and profits of *FX* for 1988 shall be computed as if no elections were made and any permissible methods of accounting not requiring an election and reflected in its books were adopted. However, a properly filed, timely election or adoption of method by, or on behalf of, *FX* with respect to its 1989 taxable year, when *P's* basis adjustment for purposes of section 864(e)(4) first constitutes a significant event, shall not be treated as a change in accounting method. No recomputation of *P's* basis adjustment for 1988 shall be required by reason of any such election or adoption of method with respect to *FX*'s 1989 taxable year, but prospective adjustments to *FX*'s earnings and profits and income shall be made to the extent required by §1.964-1T(g)(5).

Example (4)—(i) The facts are the same as in *Example (3)*, except that *FX* had subpart F income taxable to *P* in 1986, and *P* computed *FX*'s earnings and profits for purposes of determining the amount of the inclusion and the foreign taxes deemed paid by *P* in 1986 under section 960 pursuant to §1.964-1(a) through (e).

(ii) Any election made or method of accounting adopted on behalf of *FX* by *P* pursuant to §1.964-1(c) in 1986 is binding on *P* and *FX* for purposes of computing *FX*'s earnings and profits in 1986 and subsequent taxable years. Thus, in determining *P*'s basis adjustment for purposes of section 864(e)(4) in 1988 and 1989, and its deemed-paid credit with respect to the 1990 dividend, *FX*'s earnings and profits must be computed consistently with the method used by *P* with regard to the 1986 subpart F inclusion. (However, §1.964-1(d), (e), and (f) do not apply in computing *FX*'s earnings and profits in post-1986 taxable years.)

Example (5)—(i) The facts are the same as in *Example (4)*, except that *FX* made a dividend distribution to *P* on June 1, 1985, and *P* computed *FX*'s earnings and profits for purposes of computing the foreign taxes deemed paid by *P* in 1985 under section 902 with respect to the distribution under §1.964-1 exclusive of paragraphs (d), (e), and (f) pursuant to a timely election under §1.902-1(g)(1).

(ii) Any election made or method of accounting adopted on behalf of *FX* by *P* pursuant to §1.964-1(c) in 1985 is binding on *P* and *FX* for purposes of computing *FX*'s earnings and profits in 1985 and subsequent taxable years. Thus, in determining *P*'s basis adjustment for purposes of section 864(e)(4) in 1988 and 1989 and its deemed-paid credit with respect to the 1986 subpart F inclusion and the 1990 dividend, *FX*'s earnings and profits must be computed consistently with the method used by *P* with regard to the 1985 dividend. If, rather than choosing under §1.902-1(g)(1) to use the section 964 rules, *P* computed *FX*'s earnings and profits for purposes of section 902 in 1985 in all respects as if *FX* were a domestic corporation, then *P* would have been free to make elections or adopt a method of accounting on behalf of *FX* under §1.964-1(c) with respect to the subpart F inclusion in 1986. Any such election or adoption would be binding on *P* and *FX* as to the computation of *FX*'s earnings and profits in 1986 and subsequent taxable years.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved December 21, 1989.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

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Subpart I.—Foreign Currency Transactions

Section 989.—Other Definitions and Special Rules

26 CFR 1.989(a)-1: Definition of a qualified business unit.

T.D. 8279

Department of the Treasury
Internal Revenue Service
26 CFR Part 1

Definition of a Qualified Business Unit

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final Income Tax Regulations relating to the definition of a qualified business unit under section 989 of the Internal Revenue Code of 1986. This section was added to the Code by Section 1261 of the Tax Reform Act of 1986 [1986-3 C.B. (Vol. 1) 1, 502]. These final regulations define the term "Qualified Business Unit" and affect taxpayers who must make income tax determinations for their QBUs for taxable years beginning after December 31, 1986.

EFFECTIVE DATE: These regulations are effective for taxable years beginning after December 31, 1986.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On June 8, 1988, the FEDERAL REGISTER published proposed amendments (53 FR 20612 [T.D. 8206, 1988-2 C.B. 295]) to the Income Tax Regulations (26 CFR Part 1) under section 989 of the Internal Revenue Code of 1986. These amendments added regulations under section 989 of the Internal Revenue Code of 1986 defining the term "Qualified Business Unit" (QBU). This section was added to the Code by section 1261 of the Tax Reform Act of 1986 (P.L. 99-514, 100 Stat. 2085, 2090). No written comments responding to this notice were received. No public hearing was requested or held.

EXPLANATION OF PROVISIONS

Section 1.989(a)-1(a) provides that the effective date of these regulations is generally for taxable years beginning after December 31, 1986.

Section 1.989(a)-1(b) expands the definition of QBU to include partnerships, trusts, and estates. In addition, a branch of a partnership, trust, or an estate may qualify as a QBU. Because a partnership, trust, or estate is treated as a QBU of each of the partners or beneficiaries, section 987 (relating to branch transactions) may apply to remittances from a partnership, trust, or estate to partners or beneficiaries. A QBU also includes activities that produce income or loss effectively connected with a United States trade or business.

Section 1.989(a)-1(c) provides that a trade or business for purposes of section 989(a) is generally any specific unified group of activities that constitute (or could constitute) an independent economic enterprise carried on for profit, the expenses related to which are deductible under section 162 or 212 (rather than only section 162). Thus, all activities engaged in for profit are eligible for QBU status.

Section 1.989(a)-1(d) provides that books and records include those used to determine effectively connected income or loss.

SPECIAL ANALYSES

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. The authority for part 1 continues to read in part:

Authority: 26 U.S.C. 7805. ***

Par. 2. Sections 1.989(a)-0T and 1.989(a)-1T are removed and new §1.989(a)-1 is added to read as follows:

§1.989(a)-1 Definition of a Qualified Business Unit.

(a) *Applicability*—(1) *In general.* This section provides rules relating to the definition of the term "qualified business unit" (QBU) within the meaning of section 989.

(2) *Effective date.* These rules shall apply to taxable years beginning after December 31, 1986. However, any person may apply on a consistent basis §1.989(a)-1T(c) of the Temporary Income Tax Regulations in lieu of §1.989(a)-1(c) to all taxable years beginning after December 31, 1986, and on or before February 5, 1990. For the text of the temporary regulation, see 53 FR 20612 (June 8, 1988) [T.D. 8206, 1988-2 C.B. 295].

(b) *Definition of a qualified business unit*—(1) *In general.* A QBU is any separate and clearly identified unit of a trade or business of a taxpayer provided that separate books and records are maintained.

(2) *Application of the QBU definition*—

(i) *Persons.* A corporation is a QBU. An individual is not a QBU. A partnership, trust, or estate is a QBU of a partner or beneficiary.

(ii) *Activities.* Activities of a corporation, partnership, trust, estate, or individual qualify as a QBU if—

(A) The activities constitute a trade or business; and

(B) A separate set of books and records is maintained with respect to the activities.

(3) *Special rule.* Any activity (wherever conducted and regardless of its frequency) that produces income or loss that is, or is treated as, effectively connected with the conduct of a trade or business within the United States shall be treated as a separate QBU, provided the books and records requirement of paragraph (d)(2) of this section is satisfied.

(c) *Trade or business*—The determination as to whether activities constitute a trade or business is ultimately dependent upon an examination of all the facts and circumstances. Generally, a trade or business for purposes of section 989(a) is a specific unified group of activities that constitutes (or could constitute) an independent economic enterprise car-

ried on for profit, the expenses related to which are deductible under section 162 or 212 (other than that part of section 212 dealing with expenses incurred in connection with taxes). To constitute a trade or business, a group of activities must ordinarily include every operation which forms a part of, or a step in, a process by which an enterprise may earn income or profit. Such group of activities must ordinarily include the collection of income and the payment of expenses. It is not necessary that the activities carried out by a QBU constitute a different trade or business from those carried out by other QBUs of the taxpayer. A vertical, functional, or geographic division of the same trade or business may be a trade or business for this purpose provided that the activities otherwise qualify as a trade or business under this paragraph (c). However, activities that are merely ancillary to a trade or business will not constitute a trade or business under this paragraph (c). Activities of an individual as an employee are not considered by themselves to constitute a trade or business under this paragraph (c).

(d) *Separate books ad records*—(1) *General rule.* Except as provided in paragraph (d)(2) of this section, a separate set of books and records shall include books of original entry and ledger accounts, both general and subsidiary, or similar records. For example, in the case of a taxpayer using the cash receipts and disbursements method of accounting, the books of original entry include a cash receipts and disbursements journal where each receipt and each disbursement is recorded. Similarly, in the case of a taxpayer using an accrual method of accounting, the books of original entry include a journal to record sales (accounts receivable) and a journal to record expenses incurred (accounts payable). In general, a journal represents a chronological account of all transactions entered into by an entity for an accounting period. A ledger account, on the other hand, chronicles the impact during an accounting period of the specific transactions recorded in the journal for that period upon the various items shown on the entity's balance sheet (*i.e.*, assets, liabilities, and capital accounts) and income statement (*i.e.*, revenues and expenses).

(2) *Special rule.* For purposes of paragraph (b)(3) of this section, books and records include books and records used to determine income or loss that is, or is treated as, effectively connected with the conduct of a trade or business within the United States.

(e) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). Corporation X is a domestic corporation. Corporation X manufactures widgets in the U.S. for export. Corporation X sells widgets in the United Kingdom through a branch office in London. The London office has its own employees and solicits and processes orders. Corporation X maintains in the U.S. a separate set of books and records for all transactions conducted by the London office. Corporation X is a QBU under paragraph (b)(2)(i) of this section because of its corporate status. The London branch office is a QBU under paragraph (b)(2)(ii) of this section because (1) the sale of widgets is a trade or business as defined in paragraph (c) of this section; and (2) a complete and separate set of books and records (as described in paragraph (d) of this section) is maintained with respect to its sales operations.

Example (2). A domestic corporation incorporates a wholly-owned subsidiary in Switzerland. The domestic corporation is a manufacturer that markets its product abroad primarily through the Swiss subsidiary. To facilitate sales of the parent's product in Europe, the Swiss subsidiary has branch offices in France and West Germany that are responsible for all marketing operations in those countries. Each branch has its own employees, solicits and processes orders, and maintains a separate set of books and records. The domestic corporation and the Swiss subsidiary are both QBUs under paragraph (b)(2)(i) of this section because of their corporate status. The French and West German branches are QBUs of the Swiss subsidiary. They satisfy paragraph (b)(2)(ii) because each constitutes a trade or business (as defined in paragraph (c) of this section) and because separate sets of books and records (as described in paragraph (d) of this section) of their respective operations is maintained. Each branch is considered to have a trade or business although each is a geographical division of the same trade or business.

Example (3). W is a domestic corporation that manufactures product X in the United States for sale worldwide. All of W's sales functions are conducted exclusively in the United States. W employs individual Q to work in France. Q's sole function is to act as a courier to deliver sales documents to customers in France. With respect to Q's activities in France, a separate set of books and records as described in paragraph (d) is maintained. Under paragraph (c) of this section, Q's activities in France do not constitute a QBU since they are merely ancillary to W's manufacturing and selling business. Q is not considered to have a QBU because an individual's activities as an employee are not considered to constitute a trade or business of the individual under paragraph (c).

Example (4). The facts are the same as in example (3) except that the courier function is the sole activity of a wholly-owned French subsidiary of W. Under paragraph (b)(2)(i) of this section, the French subsidiary is considered to be a QBU.

Example (5). A corporation incorporated in the Netherlands is a subsidiary of a domestic corporation and a holding company for the stock of one or more subsidiaries incorporated in other countries. The Dutch corporation's activities are limited to paying its directors and its administrative expenses, receiving capital contributions from its United States parent corporation, contributing capital to its subsidiaries, receiving dividend distributions from its subsidiaries, and distributing dividends to its domestic parent corporation. Under paragraph (b)(2)(i) of this section, the Netherlands corporation is considered to be a QBU.

Example (6). Taxpayer A, an individual resident of the United States, is engaged in a trade or business wholly unrelated to any type of investment activity. A also maintains a portfolio of foreign currency-denominated investments through a foreign broker. The broker is responsible for all activities necessary to the management of A's investments and maintains books and records as described in paragraph (d) of this section, with respect to all investment activities of A. A's investment activities qualify as a QBU under paragraph (b)(2)(ii) of this section to the extent the activities engaged in by A generate expenses that are deductible under section 212 (other than that part of section 212 dealing with expenses incurred in connection with taxes).

Example (7). Taxpayer A, an individual resident of the United States, is the sole shareholder of foreign corporation (FC) whose activities are limited to trading in stocks and securities. FC is a QBU under paragraph (b)(2)(i) of this section.

Example (8). Taxpayer A, an individual resident of the United States, markets and sells in Spain and in the United States various products produced by other United States manufacturers. A has an office and employs a salesman to manage A's activities in Spain, maintains a separate set of books and records with respect to his activities in Spain, and is engaged in a trade or business as defined in paragraph (c) of this section. Therefore, under paragraph(b)(2)(ii) of this section, the activities of A in Spain are considered to be a QBU.

Example (9). Foreign corporation FX is incorporated in Mexico and is wholly owned by a domestic corporation. The domestic corporation elects to treat FX as a domestic corporation under section 1504(d). FX operates entirely in Mexico and maintains a separate set of books and records with respect to its activities in Mexico. FX is a QBU under paragraph (b)(2)(i) of this section. The activities of FX in Mexico also constitute a QBU under paragraph (b)(2)(ii) of this section.

Example (10). F, a foreign corporation, computes a gain of $100 from the disposition of a United States real property interest (as defined in section 897(c)). The gain is taken into account as if F were engaged in a trade or business in the United States and as if such gain were effectively connected with such trade or business. F is a QBU under paragraph (b)(2)(i) of this section because of its corporate status. F's disposition activity constitutes a separate QBU under paragraph (b)(3) of this section.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved November 9, 1989.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

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Subchapter O.—Gain or Loss on Disposition of Property

Part I.—Determination of Amount of and Recognition of Gain or Loss

Section 1001.—Determination of Amount of and Recognition of Gain or Loss

26 CFR 1.1001-1: Computation of gain or loss.

Exchange of investment trust certificates for trust assets; gain or loss recognition. A certificate holder in an investment trust that has a single class of ownership interests and a fixed portfolio of stocks does not recognize gain or loss when the certificates are exchanged for a proportionate share of each of the trust's assets. Rev. Rul. 68-633 revoked.

Rev. Rul. 90-7

ISSUE

If a taxpayer holds certificates in an investment arrangement classified as a trust for federal tax purposes under section 301.7701-4(c) of the Procedure and Administration Regulations, does the taxpayer realize gain or loss upon exchanging the certificates for a proportionate share of each of the trust's assets?

FACTS

TR is an arrangement created under a trust instrument and classified as a trust under section 301.7701-4(c) of the Procedure and Administration Regulations. *TR* holds a fixed portfolio consisting of common stock in 15 different corporations. Interests in *TR* are represented by certificates.

Under the terms of the trust instrument, the trustee collects dividends paid on the common stock being held by *TR* and distributes the entire amount (less an amount deposited in a reserve for administrative expenses) to the various certificate holders. Certificate holders have an undivided interest in the trust assets and share equally in any income or loss realized with respect to such assets. Certificate holders also have the right to exchange their certificates for proportionate amounts of the stocks held by *TR*.

In 1982, *A*, an individual, paid $200x$ dollars to *TR* in exchange for 100 certificates issued by *TR*. *A* exercised the exchange right in 1987, when the value of *A*'s share of *TR*'s assets was $300x$ dollars. In return for surrendering all 100 trust certificates, *A* received a proportionate amount of the stock held by *TR* in each of the 15 corporations, $1x$ dollars of cash as *A*'s proportionate share of the reserve for administrative expenses, and $4x$ dollars of cash in lieu of fractional shares of stock. The $4x$ dollars of cash that *A* received in lieu of fractional shares was funded from the other certificate holders' shares of the reserve for administrative expenses. The total value of the stock and cash *A* received was $300x$ dollars.

LAW AND ANALYSIS

Section 1001(a) of the Internal Revenue Code provides that the gain from the sale or other disposition of property shall be the excess of the amount realized over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in section 1011 for determining loss over the amount realized.

Section 1001(b) of the Code provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

Section 1001(c) of the Code provides that, except as otherwise provided in subtitle A, the entire amount of the gain or loss, determined under section 1001(a), on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income tax Regulations provides that gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or extent, is treated as income or as loss sustained.

Rev. Rul. 56-437, 1956-2 C.B. 507, concludes that there is no sale or exchange when a joint tenancy in the stock of a corporation is severed in a partition action. A division of stock among parties having undivided ownership interests in the stock is a nontaxable transaction for federal income tax purposes.

Sections 673 through 679 of the Code set forth the rules for determining when a grantor or other taxpayer is treated as the owner of an entire trust, section 671 and the regulations thereunder require the grantor to take into account in computing the grantor's tax liability, all of the trust's items of income, deduction, and credit as though the trust had not been in existence during the period the grantor is treated as the owner. Section 1.671-3(a)(1) of the regulations.

Rev. Rul. 84-10, 1984-1 C.B. 155, considers mortgage pools created by the Federal National Mortgage Association (FNMA) pursuant to a trust agreement. Each pool consists of residential mortgages transferred to FNMA by a single mortgage lender in exchange for trust certificates. The trust certificates represent fractional undivided interests in the mortgage loans, pool proceeds, mortgaged property acquired by foreclosure that has not been withdrawn from the pool, and FNMA's obligation to supplement the pool proceeds in certain events. Rev. Rul. 84-10 concludes that each pool is classified as a trust and that each certificate holder is treated as the owner of an undivided interest in the entire trust under section 671 of the Code.

When a grantor is treated as the owner of an entire trust, the grantor is considered to be the owner of the trust assets for federal income tax purposes. Rev. Rul. 85-13, 1985-1 C.B. 184.

Under the terms of *TR*'s trust in-

strument, *A*'s certificates represented an undivided interest in *TR*'s assets and any income or loss realized on them. Therefore, like a certificate holder in the mortgage pool described in Rev. Rul. 84-10, *A* was an owner of an undivided interest in all of *TR* under section 671 of the Code. As an owner of an undivided interest in all of *TR* under section 671, *A* was considered an owner of an undivided interest in all of *TR*'s assets for federal income tax purposes. Rev. Rul. 85-13. Thus, when *A* exchanged the certificates, *A* went from being a co-owner of all *TR*'s stock to being sole owner of a proportionate share of that stock. *A* realized no gain or loss because like a partition of stock among co-owners, the exchange effected no material difference in *A*'s position. Rev. Rul. 56-437.

A also received 4*x* dollars of cash in lieu of fractional shares of the stock held by *TR*. *A* realized and must recognize gain or loss measured by the difference between the amount of cash received and the adjusted basis in the fractional shares as determined under section 1011 of the Code. *A* recognized no gain or loss on the receipt of *A*'s 1*x* dollar share of the reserve for administrative expenses.

Rev. Rul. 68-633, 1968-2 C.B. 329, considers the conversion of shares in an investment trust into the underlying stock held by the trust. That transaction does not materially differ from the one between *A* and *TR*. Rev. Rul. 68-633 concludes that the transaction results in the recognition of gain or loss. Rev. Rul. 68-633 is inconsistent with the position of the Internal Revenue Service that the holder of the undivided interest in the investment trust owns an undivided interest in the trust assets for federal income tax purposes so that after the exchange the holder is in essentially the same position as before the exchange. Accordingly, Rev. Rul. 68-633 is revoked.

HOLDING

A does not realize gain or loss upon exchanging certificates in *TR* for a proportionate share of the stock held by *TR*. However gain or loss is realized and recognized to the extent cash received in lieu of fractional shares exceeds (or falls short of) *A*'s adjusted basis in the fractional shares.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 68-633 is revoked.

PROSPECTIVE APPLICATION

Pursuant to the authority granted by section 7805(b) of the Code, the holding of this ruling will not be applied adversely to a taxpayer if the exchange of trust certificates for trust assets occurred before January 29, 1990. Any gain or loss reported pursuant to Rev. Rul. 68-633 must be reflected in corresponding adjustments to the basis of the trust assets received, pursuant to section 1.1016-6 of the Income Tax Regulations.

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26 CFR 1.1001-1: Computation of gain or loss.

A corporation's adoption of a "poison pill" plan does not cause any taxpayer to realize gross income. See Rev. Rul. 90-11, page 10.

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26 CFR 1.1001-2: Computation of gain or loss.

If an insolvent taxpayer transfers to a creditor property with a fair market value in excess of basis in satisfaction of a debt on which the taxpayer is personally liable and which is secured by the property, does such transfer result in the recognition of gain. See Rev. Rul. 90-16, page 12.

Part III.—Common Nontaxable Exchanges

Section 1031.—Exchange of Property Held for Productive Use or Investment

26 CFR 1.1031(a)-1: Property held for productive use in trade or business or for investment.

Direct transfers of like-kind property. *X*'s transfer of property to *Y*, in exchange for property of a like kind, qualifies as to *X* for nonrecognition of gain or loss on the exchange under section 1031 of the Code even though legal title to the property received by *X* is never held by *Y*.

Rev. Rul. 90-34

ISSUE

If *X* transfers property to *Y* in exchange for property of a like kind, may the exchange as to *X* qualify for nonrecognition of gain or loss under section 1031 of the Internal Revenue Code even though legal title to the property received by *X* is never held by *Y*?

FACTS

X and *Y* are unrelated persons. *X* files its U.S. income tax return on a calendar year basis. On May 14, 1989, *X* and *Y* enter into a contract that requires *X* to transfer Blackacre to *Y* and *Y* to transfer to *X* property of a like kind with the same fair market value. Blackacre, unencumbered real property, has been held by *X* for productive use in its trade or business and has a fair market value of $1,000,000. Under the contract, *X* is required to locate and identify property with a fair market value of $1,000,000 that is of a like kind to Blackacre within 45 days of *X*'s transfer of Blackacre to *Y* (the "identification period"), and *Y* is required to purchase and transfer the identified property to *X* before the earlier of 180 days from the transfer of Blackacre or the due date (including extensions) for *X*'s U.S. income tax return for the taxable year in which *X*'s transfer of Blackacre to *Y* occurs (the "exchange period"). If *X* fails to identify the property to be received in the transaction before the end of the identification period or *Y* fails to purchase and transfer such property to *X* before the end of the exchange period, *Y* is required to pay $1,000,000 to *X*. Neither *X* nor *Y* contracts to exchange Blackacre with any other party.

On May 23, 1989, *X* transfers Blackacre to *Y*. On June 1, 1989, *X* properly identifies Whiteacre as the property to be received. Whiteacre, owned by *Z*, a person unrelated to *X*, is unencumbered real property that has a fair market value of $1,000,000 and is of a like kind to Blackacre. On July 10, 1989, *Y* purchases Whiteacre from *Z*, and, at *Y*'s direction, *Z* transfers legal title to Whiteacre directly to *X* before the end of the exchange period. *X*, thereafter, holds Whiteacre for productive use in its trade or business.

LAW AND ANALYSIS

Under section 1031(a)(1) of the Code, no gain or loss is recognized on the exchange of property held for productive use in a trade or business

or for investment if such property is exchanged solely for property of like kind that is to be held either for productive use in a trade or business or for investment.

Section 1031(a)(3) of the Code provides that any property received by a taxpayer will be treated as property which is not like-kind property if (A) such property is not identified as property to be received in the exchange on or before the day which is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or (B) such property is received after the earlier of (i) the day which is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange, or (ii) the due date (including extensions) for the taxpayer's federal income tax return for the taxable year in which the transfer of the relinquished property occurs.

If *Z* had actually transferred legal title to Whiteacre to *Y* and *Y* had then transferred legal title to Whiteacre to *X*, the exchange of Whiteacre for Blackacre, as to *X*, would clearly qualify for nonrecognition of gain or loss under section 1031(a) of the Code. However, section 1031(a) does not require that *Y* hold legal title to Whiteacre, but merely that *X* receive solely property of a like kind to the property transferred in order for the exchange to qualify for nonrecognition of gain or loss. Therefore, the failure of *Y* to acquire legal title to Whiteacre does not disqualify *X* from nonrecognition of gain or loss under section 1031(a) on the transfer of Blackacre to *Y* in exchange for White acre.

HOLDING

X's transfer of property to *Y*, in exchange for property of a like kind, qualifies as to *X* for nonrecognition of gain or loss on the exchange under section 1031 of the Code even though legal title to the property received by *X* is never held by *Y*.

Subchapter P.—Capital Gains and Losses

Part IV.—Special Rules for Determining Capital Gains and Losses

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Section 1248.—Gain From Certain Sales or Exchanges of Stock in Certain Foreign Corporations

26 CFR 1.1248-1: Treatment of gain from certain sales or exchanges of stock in certain foreign corporations.

Earnings and profits of a controlled foreign corporation are decreased by amounts previously included in gross income of the transferor shareholder as a dividend under section 1248 of the Code at the time of the actual distribution of the section 951(a)(1)(A) amount attributable to such section 1248 dividend. See Rev. Rul. 90-31, page 147.

Part V.—Special Rules for Bonds and Other Debt Instruments

Subpart A.—Original Issue Discount

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for January 1990.

Rev. Rul. 90-1

This revenue ruling provides various prescribed rates for federal income tax purposes for January 1990 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long- term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 90-1 TABLE 1
Applicable Federal Rates (AFR) for January 1990

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	7.90%	7.75%	7.68%	7.63%
110% AFR	8.71%	8.53%	8.44%	8.38%
120% AFR	9.52%	9.30%	9.19%	9.12%
Mid-Term				
AFR	7.94%	7.79%	7.72%	7.67%
110% AFR	8.75%	8.57%	8.48%	8.42%
120% AFR	9.57%	9.35%	9.24%	9.17%
150% AFR	12.03%	11.69%	11.52%	11.42%
175% AFR	14.09%	13.63%	13.41%	13.26%
Long-Term				
AFR	8.02%	7.87%	7.79%	7.74%
110% AFR	8.85%	8.66%	8.57%	8.51%
120% AFR	9.66%	9.44%	9.33%	9.26%

REV. RUL. 90-1 TABLE 2
Adjusted AFR for January 1990

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	5.84%	5.76%	5.72%	5.69%
Mid-term adjusted AFR	6.29%	6.19%	6.14%	6.11%
Long-term adjusted AFR	6.85%	6.74%	6.68%	6.65%

REV. RUL. 90-1 TABLE 3
Rates Under Section 382 for January 1990

Adjusted federal long-term rate for the current month	6.85%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months).	7.03%

REV. RUL. 90-1 TABLE 4
Appropriate Percentages Under Section 42(b)(2) for January 1990

Appropriate percentage for the 70% present value low-income housing credit	8.89%
Appropriate percentage for the 30% present value low-income housing credit	3.81%

REV. RUL. 90-1 TABLE 5
Rate under section 7520 for January 1990

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder of reversionary interest	9.6%

(Also Sections 42, 280G, 382, 412, 467, 468, 483, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for February 1990.

Rev. Rul. 90-12

This revenue ruling provides various prescribed rates for federal income tax purposes for February 1990 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 90-12 TABLE 1

Applicable Federal Rates (AFR) for February 1990

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	7.98%	7.83%	7.75%	7.71%
110% AFR	8.80%	8.61%	8.52%	8.46%
120% AFR	9.62%	9.40%	9.29%	9.22%
Mid-Term				
AFR	8.06%	7.90%	7.82%	7.77%
110% AFR	8.88%	8.69%	8.60%	8.54%
120% AFR	9.70%	9.48%	9.37%	9.30%
150% AFR	12.20%	11.85%	11.68%	11.57%
175% AFR	14.31%	13.83%	13.60%	13.45%
Long-Term				
AFR	8.12%	7.96%	7.88%	7.83%
110% AFR	8.95%	8.75%	8.67%	8.60%
120% AFR	9.78%	9.55%	9.44%	9.37%

REV. RUL. 90-12 TABLE 2

Adjusted AFR for February 1990

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	5.86%	5.78%	5.74%	5.71%
Mid-term adjusted AFR	6.23%	6.14%	6.09%	6.06%
Long-term adjusted AFR	6.72%	6.61%	6.56%	6.52%

REV. RUL. 90-12 TABLE 3

Rates Under Section 382 for February 1990

Adjusted federal long-term rate for the current month	6.72%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months).	7.01%

REV. RUL. 90-12 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for February 1990

Appropriate percentage for the 70% present value low-income housing credit	8.91%
Appropriate percentage for the 30% present value low-income housing credit	3.82%

REV. RUL. 90-12 TABLE 5

Rate under section 7520 for February 1990

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	9.8%

(Also Sections 42, 280G, 382, 412, 467, 468, 483, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for March 1990.

Rev. Rul. 90-22

This revenue ruling provides various prescribed rates for federal income tax purposes for March 1990 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 90-22 TABLE 1

Applicable Federal Rates (AFR) for March 1990

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	8.35%	8.18%	8.10%	8.04%
110% AFR	9.20%	9.00%	8.90%	8.84%
120% AFR	10.06%	9.82%	9.70%	9.62%
Mid-Term				
AFR	8.52%	8.35%	8.26%	8.21%
110% AFR	9.40%	9.19%	9.09%	9.02%
120% AFR	10.27%	10.02%	9.90%	9.82%
150% AFR	12.92%	12.53%	12.34%	12.21%
175% AFR	15.14%	14.61%	14.35%	14.18%
Long-Term				
AFR	8.59%	8.41%	8.32%	8.27%
110% AFR	9.46%	9.25%	9.15%	9.08%
120% AFR	10.34%	10.09%	9.97%	9.88%

REV. RUL. 90-22 TABLE 2

Adjusted AFR for March 1990

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	5.93%	5.84%	5.80%	5.77%
Mid-term adjusted AFR	6.27%	6.17%	6.12%	6.09%
Long-term adjusted AFR	6.89%	6.78%	6.72%	6.69%

REV. RUL. 90-22 TABLE 3

Rates Under Section 382 for March 1990

Adjusted federal long-term rate for the current month	6.89%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months).	6.89%

REV. RUL. 90-22 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for March 1990

Appropriate percentage for the 70% present value low-income housing credit	9.03%
Appropriate percentage for the 30% present value low-income housing credit	3.87%

REV. RUL. 90-22 TABLE 5

Rate under section 7520 for March 1990

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	10.2%

(Also Sections 42, 280G, 382, 412, 467, 468, 483, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for April 1990.

Rev. Rul. 90-28

This revenue ruling provides various prescribed rates for federal income tax purposes for April 1990 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 90-28 TABLE 1

Applicable Federal Rates (AFR) for April 1990

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	8.56%	8.38%	8.29%	8.24%
110% AFR	9.43%	9.22%	9.12%	9.05%
120% AFR	10.31%	10.06%	9.94%	9.86%
Mid-Term				
AFR	8.75%	8.57%	8.48%	8.42%
110% AFR	9.65%	9.43%	9.32%	9.25%
120% AFR	10.54%	10.28%	10.15%	10.07%
150% AFR	13.27%	12.86%	12.66%	12.53%
175% AFR	15.56%	15.00%	14.73%	14.55%
Long-Term				
AFR	8.75%	8.57%	8.48%	8.42%
110% AFR	9.65%	9.43%	9.32%	9.25%
120% AFR	10.54%	10.28%	10.15%	10.07%

REV. RUL. 90-28 TABLE 2

Adjusted AFR for April 1990

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	5.94%	5.85%	5.81%	5.78%
Mid-term adjusted AFR	6.25%	6.16%	6.11%	6.08%
Long-term adjusted AFR	6.96%	6.84%	6.78%	6.74%

REV. RUL. 90-28 TABLE 3

Rates Under Section 382 for April 1990

Adjusted federal long-term rate for the current month	6.96%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months).	6.96%

REV. RUL. 90-28 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for April 1990

Appropriate percentage for the 70% present value low-income housing credit	9.07%
Appropriate percentage for the 30% present value low-income housing credit	3.89%

REV. RUL. 90-28 TABLE 5

Rate under section 7520 for April 1990

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	10.6%

(Also Sections 42, 280G, 382, 412, 467, 468, 483, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for May 1990.

Rev. Rul. 90-41

This revenue ruling provides various prescribed rates for federal income tax purposes for May 1990 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 90-41 TABLE 1

Applicable Federal Rates (AFR) for May 1990

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	8.65%	8.47%	8.38%	8.32%
110% AFR	9.54%	9.32%	9.21%	9.14%
120% AFR	10.42%	10.16%	10.03%	9.95%
Mid-Term				
AFR	8.81%	8.62%	8.53%	8.47%
110% AFR	9.70%	9.48%	9.37%	9.30%
120% AFR	10.61%	10.34%	10.21%	10.12%
150% AFR	13.35%	12.93%	12.73%	12.59%
175% AFR	15.66%	15.09%	14.82%	14.64%
Long-Term				
AFR	8.74%	8.56%	8.47%	8.41%
110% AFR	9.64%	9.42%	9.31%	9.24%
120% AFR	10.53%	10.27%	10.14%	10.06%

REV. RUL. 90-41 TABLE 2

Adjusted AFR for May 1990

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	6.14%	6.05%	6.00%	5.98%
Mid-term adjusted AFR	6.55%	6.45%	6.40%	6.36%
Long-term adjusted AFR	7.05%	6.93%	6.87%	6.83%

REV. RUL. 90-41 TABLE 3

Rates Under Section 382 for May 1990

Adjusted federal long-term rate for the current month	7.05%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and prior two months).	7.05%

REV. RUL. 90-41 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for May 1990

Appropriate percentage for the 70% present value low-income housing credit	9.08%
Appropriate percentage for the 30% present value low-income housing credit	3.89%

REV. RUL. 90-41 TABLE 5

Rate under section 7520 for May 1990

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	10.6%

(Also Sections 42, 280G, 382, 412, 467, 468, 483, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for June 1990.

Rev. Rul. 90-48

This revenue ruling provides various prescribed rates for federal income tax purposes for June 1990 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 90-48 TABLE 1

Applicable Federal Rates (AFR) for June 1990

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	8.82%	8.63%	8.54%	8.48%
110% AFR	9.72%	9.49%	9.38%	9.31%
120% AFR	10.63%	10.36%	10.23%	10.14%
Mid-Term				
AFR	9.10%	8.90%	8.80%	8.74%
110% AFR	10.03%	9.79%	9.67%	9.60%
120% AFR	10.97%	10.68%	10.54%	10.45%
150% AFR	13.80%	13.35%	13.13%	12.99%
175% AFR	16.19%	15.58%	15.29%	15.10%
Long-Term				
AFR	9.09%	8.89%	8.79%	8.73%
110% AFR	10.02%	9.78%	9.66%	9.59%
120% AFR	10.95%	10.67%	10.53%	10.44%

REV. RUL. 90-48 TABLE 2

Adjusted AFR for June 1990

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	6.40%	6.30%	6.25%	6.22%
Mid-term adjusted AFR	6.68%	6.57%	6.52%	6.48%
Long-term adjusted AFR	7.19%	7.07%	7.01%	6.97%

REV. RUL. 90-48 TABLE 3

Rates Under Section 382 for June 1990

Adjusted federal long-term rate for the current month	7.19%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months).	7.19%

REV. RUL. 90-48 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for June 1990

Appropriate percentage for the 70% present value low-income housing credit	9.16%
Appropriate percentage for the 30% present value low-income housing credit	3.93%

REV. RUL. 90-48 TABLE 5

Rate under section 7520 for June 1990

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	11.0%

Subpart D.—Miscellaneous Provisions

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1990. See Rev. Rul. 90-1, page 155.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1990. See Rev. Rul. 90-12, page 156.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1990. See Rev. Rul. 90-22, page 158.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 1990. See Rev. Rul. 90-28, page 159.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth in the month of May 1990. See Rev. Rul. 90-41, page 161.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 1990. See Rev. Rul. 90-48, page 162.

Subchapter F.—Title 11 Cases

Section 1398.—Rules Relating to Individuals' Title 11 Cases

Rev. Rul. 74-26, 1974-1 C.B. 7, relating to transfers (other than by sale or exchange) of section 38 property from an individual debtor to a trustee in a bankruptcy proceeding that was commenced after March 24, 1981, is declared obsolete. See Rev. Rul. 90-25, page 10.

Chapter 3.—Withholding of Tax on Nonresident Aliens and Foreign Corporations

Subchapter A.—Nonresident Aliens and Foreign Corporations

Section 1441.—Withholding of Tax on Nonresident Aliens

26 CFR 1.1441-4: Exemptions from withholding.

T.D. 8288

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Withholding of Tax on Nonresident Aliens

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulation.

SUMMARY: This document contains a temporary Income Tax Regulation relating to withholding of tax on certain payments made to nonresident aliens. This temporary regulation is necessary to provide appropriate guidance with respect to withholding upon payments to a nonresident alien individual from an employees' trust described in section 401(a) of the Internal Revenue Code of 1986 (the "Code") that is exempt from tax under section 501(a) of the Code. The temporary regulation will affect both individuals and withholding agents. The text of the temporary regulation set forth in this document also serves as the text of the proposed regulation cross-referenced in the notice of proposed rulemaking in *** [INTL-0660-89, page 680, this Bulletin].

DATES: The temporary regulation is effective and applicable for payments made after February 26, 1990.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains a temporary Income Tax Regulation (26 CFR Part 1) under section 1441 of the Code.

NEED FOR A TEMPORARY REGULATION

Immediate guidance is necessary for withholding agents with respect to payments to which this section applies. Therefore, good cause is found to dispense with the notice and public procedure requirements of 5 U.S.C. §553(b) and the delayed effective date requirement of 5 U.S.C. §553(d).

EXPLANATION OF PROVISION

Prior to 1987, certain deferred payments made in a year in which the taxpayer was not engaged in a U.S. trade or business were not treated as effectively connected income even though such payments were attributable to a year in which the taxpayer was engaged in a U.S. trade or business. Section 1242(a) of the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2580, [1986-3 C.B. (Vol. 1) 1, 497] added new section 864(c)(6) to the Code. Section 864(c)(6) treats certain deferred payments (including those attributable to the performance of services) made in a year in which the taxpayer is not engaged in a U.S. trade or business, but attributable to another year in which the taxpayer was so engaged in a U.S. trade or business, as effectively connected income. Pensions are treated as compensation for services under 31.3401(a)-1(a)(2). This 1986 Act change in the characterization of such deferred compensation as effectively connected income necessitates a clarification of the regulations under section 1441 to ensure appropriate withholding upon certain deferred compensation payments made to nonresident aliens. Section 1441 requires withholding of taxes on certain types of income paid to nonresident aliens; exceptions to this statutory rule are authorized for compensation for personal services only to the extent such compensation is exempt under a tax treaty or is subject to wage withholding under section 3402. Special rules with respect to withholding upon certain deferred income are contained in section 3405. Section 864(c)(6) is effective for taxable years beginning after December 31, 1986.

Section 1.1441-4T(b)(1)(ii) is added to clarify that payments made to a nonresident alien individual from any employees' trust described in section 401(a) which is exempt from tax under section 501(a) are not subject to the exception from withholding under section 1441 if an election of no withholding under section 3405(a)(2) of (b)(3) is in effect. Accordingly, if an election of no withholding under section 3405(a)(2) or (b)(3) is in effect, such payments are subject to withholding under section 1441.

SPECIAL ANALYSES

It has been determined that this rule is not a major rule as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to this regulation, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comments on their impact on small business.

* * * * *

Adoption of amendment to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

INCOME TAX REGULATIONS (26 CFR Part 1)

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805. ***Sections 1.1441-4(b)(1)(ii) and 1.1441-4T also issued under 26 U.S.C. 1441(c)(4).***

Par. 2. Section 1.1441-4 is amended by revising paragraph (b)(1)(ii) to read as follows:

1.1441-4 Exemptions from withholding.

* * * * *

(b) *Compensation for personal services of an individual—(1) Exemption from withholding.****

(ii) [Reserved] For guidance, see §1.1441-4T(b)(1)(ii).

* * * * *

Par. 3. A new §1.1441-4T is added immediately after §1.1441-4 to read as follows:

1.1441-4T Exemption from withholding.

(Temporary regulation).

(a) [Reserved]

(b) *Compensation for personal services of an individual—(1) Exemption from withholding.*

(i) [Reserved]

(ii) Withholding is not required under §1.1441-1 from salaries, wages, remuneration, or any other compensation for personal services of a nonresident alien individual if such compensation is effectively connected with the conduct of a trade or business within the United States and such compensation would be subject to withholding under section 3402 but for the provisions of section 3401(a) (other than paragraph (a)(6) thereof) and the regulations under that section, provided that an election of no withholding under section 3405(a)(2) or (b)(3) is not in effect.

(b)(1)(iii) through (5) [Reserved]
(c) through (i) [Reserved]

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved December 28, 1989.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 2, 1990, 8:45 a.m., and published in the issue of the Federal Register for February 5, 1990, 55 F.R. 3716)

Chapter 6.—Consolidated Returns
Subchapter A.—Returns and Payment of Tax

Section 1502.—Regulations

Temporary regulations under section 1502 of the Code relate to dispositions and deconsolidations of the stock of a subsidiary by a member of a group of corporations filing consolidated returns. See T.D. 8294, page 66.

26 CFR 1.1502-13: Intercompany transactions.

T.D. 8295

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Consolidated Return Regulations—Modification of Rules Relating to Intercompany Transactions and Distributions of Property

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary and final regulations.

SUMMARY: This document contains temporary and final regulations under section 1502 that relate to deferred intercompany transactions and distributions of property among members of an affiliated group filing consolidated returns. As a result of changes to the Internal Revenue Code, literal application of the deferral rules may produce tax consequences to the group that are inconsistent with the tax consequences that would have resulted if an intercompany transfer had not occurred.

The temporary regulations provide rules concerning the creation and restoration of deferred gain or loss in these transfers. The purpose of the temporary regulations is to confirm the original intent of the deferral mechanism by assuring that intercompany transfers generally do not affect the overall federal income tax consequences to the group. The text of the temporary regulations set forth in this document also serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in *** [CO-008-90, page 559, this Bulletin].

DATES: These temporary and final regulations are effective for taxable years for which the due date (without extensions) of the federal income tax return is after March 14, 1990. However, transition rules §§1.1502-13T(m)(4)(ii) and 1.1502-14T(c)(3)(ii) apply to certain dispositions outside the group occurring before March 9, 1990. In addition, §1.1502-13T(n) applies only to intercompany transactions attributable to long term contracts entered into after June 20, 1988.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

This regulation is being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information requirement contained in this regulation has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under control number 1545-1161. The estimated annual burden per respondent varies from 1 1/2 to 2 1/2 hours, depending on individual circumstances, with an estimated average of 2 hours.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents may require greater or less time, depending on their particular circumstances.

For further information concerning these collections of information, where to submit comments on these collections of information, the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referenced notice of proposed rulemaking published in *** [CO-008-90, page 559, this Bulletin].

Background

This document amends the Income Tax Regulations (26 CFR Part 1) under section 1502 of the Internal Revenue Code of 1986. The temporary and final regulations added by this document amend §§1.1502-13T and 1.1502-14T and amend and add cross-references to §§1.1502-13 and 1.1502-14. The temporary and final regulations added by this document will remain in effect until superseded by later temporary or final regulations relating to these matters.

The present consolidated return regulations provide a system which replicates in many ways the federal income tax consequences which would arise if the members of an affiliated group of corporations filing consolidated returns were a single entity. Under the regulations, gain or loss realized and recognized on transfers of property from one member ("selling member") to another member ("purchasing member") of an affiliated group filing consolidated returns is deferred and taken into account by the selling member when, for example, the property is depreciated or disposed of outside the group by the purchasing member. Although the gain or loss is deferred, the purchasing member has a cost basis in the transferred property. See §§1.1502-13, 1.1502-13T, 1.1502-14, 1.1502-14T, and 1.1502-31(a).

Prior to 1966, the consolidated return regulations provided for the elimination of the selling member's gain or loss if the property was not sold outside the group during the same consolidated return year. Under the prior regulations, the purchasing member received a carryover basis in the property.

The change to the deferral system was made because the gain elimination system resulted in certain gain escaping tax, being recognized by the wrong member of the group at the wrong time, and being characterized improperly. Further, the earnings and profits of the members were not properly reflected.

The deferral mechanism was adopted to fix more accurately the location, character and source of the gain

or loss on transactions between members. It generally was not intended to affect the group's overall income or loss (or other tax consequences) either while the transferred property remains in the group or after the property is disposed of outside the group.

As a result of changes in the Internal Revenue Code, literal application of the deferral rules may produce tax consequences to the group that are inconsistent with the tax consequences that would have resulted if an intercompany transfer had not occurred. The purpose of the temporary regulations is to assure that the deferral provisions operate as they were intended—*i.e.*, to promote neutrality so that the overall tax consequences to the group generally are not affected by transfers of property among members.

Explanation of Provisions

Consistent with the neutrality principle, the temporary regulations provide four general rules concerning the creation and restoration of gain or loss deferred as the result of transfers of property between members of a group.

First, under the temporary regulations, any gain or loss deferred with respect to property sold or exchanged in an intercompany transaction or distributed by one member to another is taken into account in an amount equal to any increase (or decrease) in a deduction or basis recovery attributable to the increase (or decrease) in the basis of the property (or that of any other property the basis of which is determined, directly or indirectly, in whole or in part, by reference to the basis of the property) resulting from the transfer. For example, if, as a result of an intercompany transfer, the purchasing member takes depreciation deductions in excess of the deductions that would have been taken by the selling member, deferred gain must be taken into account at the same time and in the same amount as the excess depreciation deductions. For purposes of this rule, basis is not treated as recovered by reason of a subsequent intercompany transfer.

Second, if property sold or exchanged in an intercompany transaction or distributed by one member to another member (or property the basis of which is determined, directly or indirectly, in whole or in part, by reference to the basis of the property) is disposed of outside the group, deferred gain (and any associated tax consequences) generally must be taken into account as if the selling member had disposed of the property at the time and in the same manner as the member making the disposition. The source and character of the gain to the selling member and the status of the selling member for tax purposes, however, is determined at the time of the intercompany transfer. This rule applies to the property disposed of in a non-recognition transaction only to the extent gain or loss is recognized.

For purposes of this rule, an event (other than a non-recognition transaction) requiring restoration of gain under §1.1502-13(e) or (f) constitutes a disposition of property outside the group. For example, under this rule, if the parent of a group recognizes and defers gain on the sale of property to a subsidiary, and the subsidiary makes an installment sale of the property outside the group, the deferred tax liabilities of both the parent and the subsidiary must be taken into account in determining the interest charge under section 453A beginning with the taxable year in which the subsidiary's sale occurs.

Third, the temporary regulations provide a special rule for long term contracts subject to section 460. Generally, where a member has entered into a long term contract and is required to account under section 460 for any income and expense attributable to the contract, any other member's activities that benefit, or are performed by reason of, the long term contract must also be accounted for under section 460 (*i.e.*, generally under the percentage of completion method). See Notice 89-15, Q&A-8, 1989-1 C.B. 634, 636. The temporary regulations provide that as the selling member incurs costs attributable to such activities, it must recognize and may not defer gain or loss associated with income and expense accounted for (or required to be accounted for) under the percentage of completion method.

Fourth, the temporary regulations provide a rule for the restoration of gain attributable to a distribution of the stock of a subsidiary by one member to another. Upon a disposition of the stock of the subsidiary, the distributing member must take into account the deferred gain to the extent that, absent the adjustment to the basis (or excess loss account) of the subsidiary stock resulting from the distribution, the member disposing of the subsidiary stock would have had an excess loss account or increased excess loss account with respect to the subsidiary stock. In addition, following a disposition of the stock of the subsidiary, the distributing member must take into account the deferred gain to the extent that, absent the adjustment to the basis of the former subsidiary's stock resulting from the distribution, distributions with respect to the stock of the former subsidiary owned by a member exceed the member's basis in such stock. For this purpose, a disposition is defined in §1.1502-19(b)(2), and, for example, includes a case in which a distributed subsidiary ceases to be a member of the group as the result of issuing additional stock outside the group, even though the group retains all of the stock distributed.

Effective Dates

The temporary regulations generally apply to intercompany transfers or dispositions outside the group in taxable years of the group for which the due date (without extensions) of the income tax return is after March 14, 1990. However, several special rules are provided.

First, where property sold or exchanged in an intercompany transaction or distributed from one member to another member is disposed of outside the group, the temporary regulations do not apply if the intercompany transfer, resulting in deferred gain or loss, occurred before January 1, 1989, and the property was disposed of before March 9, 1990. The temporary regulations apply, however, if the intercompany transfer occurred after December 31, 1988, and the property was disposed of before March 9, 1990, unless, at the time of the intercompany transfer, there was no plan or intention to dispose of such property outside the group, and the group files a disclosure statement for the taxable year in which the property is disposed of outside the group.

Second, the temporary regulations apply only to long term contracts entered into by a member after June 20, 1988.

Third, where stock of a subsidiary distributed from one member of the group to another is considered disposed of outside the group, the temporary regulations do not apply to gain deferred with respect to the distributed stock if the distribution of the stock occurred before January 1, 1989, and the stock was disposed of before March 9, 1990.

The temporary regulations do not limit the application, to transactions occurring before or after the effective date of the regulations, of other sections of the Code or general principles of tax law, including sections 337(d) and 482, the substance-over-form doctrine (*e.g.*, application of *Commissioner v. Waterman Steamship Corp.*, 430 F.2d 1185 (5th Cir. 1970), *cert. denied*, 401 U.S. 939 (1971)), and the tax benefit rule.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Chapter I, Part 1 is amended as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1986.

Paragraph 1. The authority citation for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805 *** Sections 1.1502-13T and 1.1502-14T also issued under 26 U.S.C. 1502.

Par. 2. Section 1.1502-13 is amended as follows:

1. A new sentence is added to the end of paragraph (c)(1)(iii) to read as set forth below:

§1.1502-13 Intercompany transactions.

****

(c) ***

(1) ***

(iii) *** See §1.1502-13T, relating to the time and manner of restoring deferred gain or loss in taxable years for which the due date (without extensions) of the income tax return is after March 14, 1990.

* * * * *

Par. 3. Section 1.1502-13T is amended as follows:

1. The last sentence of paragraph (c)(2) is removed.

2. The last sentence of paragraph (f)(2) is removed.

3. New paragraphs (l), (m), (n), and (o) are added to read as follows:

§1.1502-13T. Temporary regulations for certain intercompany transactions.

*****

(l) *Restoration of deferred gain before disposition outside group*—(1) *In general.* For purposes of §1.1502-13, gain (or loss) deferred with respect to property sold or exchanged in an intercompany transaction shall be taken into account for any taxable year (whether consolidated or separate) in an amount equal to any increase (or decrease) in a deduction or basis recovery for the taxable year that is attributable to an increase (or decrease) in the basis of the property (or to the basis of any other property the basis of which is determined, directly or indirectly, in whole or in part, by reference to the basis of such property) resulting from the sale or exchange. For purposes of the preceding sentence, basis shall not be treated as recovered by reason of a subsequent deferred intercompany transaction or distribution described in §1.1502-14(a) or (b).

(2) *Examples.* The application of this paragraph (l) is illustrated by the following examples.

Example (1). (i) Corporations P and S file consolidated returns on a calendar year basis. P owns a 40% interest in the capital and profits of XYZ, a partnership. P has a basis of $20 in its partnership interest. XYZ owns a single depreciable asset. P's share of the basis of the asset is $20 and its share of the value of the asset is $60. In 1989, P sells its partnership interest to S for $60 and recognizes a gain of $40, all of which is deferred under §1.1502-13(c). S's basis in the XYZ interest is increased to $60 under §1.1502-31(a). Because XYZ has made an election under section 754, the basis of the asset with respect to S is increased, under section 743, to $60 by reference to S's basis in the XYZ interest.

(ii) If P had not transferred its partnership interest to S, its allocable share of depreciation with respect to the asset would have been $5 for 1990. As a result of the basis adjustment under section 743 resulting from the sale of the XYZ interest to S, S's depreciation with respect to the asset for 1990 is $15 ($10 of which is attributable to the basis adjustment). P is therefore required to take into account $10 of deferred gain under this paragraph (l).

(iii) In 1991, XYZ sells the asset and S's share of the amount realized with respect to the sale is $65. Without regard to depreciation for 1991, if P had not transferred its XYZ interest to S, its basis recovery on the sale of the asset would have been $15. As a result of the basis adjustment under section 743 resulting from the sale of the XYZ interest to S, S's share of the basis of the asset at the time it is sold is $45 ($60 minus $15). Accordingly, there has been a $30 increase in basis recovery in 1991 as a result of the sale of the XYZ interest to S and, under this paragraph (l), P must therefore take into account the remaining $30 of deferred gain at the time of the sale.

Example (2). (i) Corporations P and S file consolidated returns on a calendar year basis. S purchases and places in service on August 1, 1989, construction equipment costing $1,000,000. S elects to use the straight-line method over the equipment's recovery period (5 years) and appropriately applies the half-year convention to compute its depreciation deduction for the equipment. Thus, S's depreciation deduction for the equipment for 1989 is $100,000 (1/2 of 20% of $1,000,000). In 1990, S sells the equipment to P and recognizes a gain of $500,000, all of which is deferred under §1.1502-13(c). P does not dispose of the equipment before 1996.

(ii) Under section 168(i)(7), P must use the same depreciation method that S used over S's remaining recovery period for so much of the adjusted basis of the equipment in P's hands as does not exceed the adjusted basis of the equipment in S's hands immediately before the sale (the "carryover portion"). Therefore, P's depreciation deduction that is attributable to the carryover portion is the same in each year as S's deduction would have been if S had not sold the equipment to P. The amount of the deferred gain attributable to the equipment that S must take into account in any year (that is, the amount of the increased depreciation deduction to the group) is the amount of the depreciation deduction attributable to the portion of P's basis which exceeds the carryover portion (the "excess portion"). P appropriately depreciates the excess portion ($500,000) under the 200-percent declining balance method over a 5-year recovery period, applying a half-year convention. Thus, the amount of deferred gain that S is required to take into account, which equals the amount of depreciation claimed by P on the excess portion, is $100,000 for 1990, $160,000 for 1991, $96,000 for 1992, $57,600 for 1993, $57,600 for 1994, and $28,800 for 1995.

(3) *Effective date.* This paragraph

(l) applies to intercompany transactions in taxable years for which the due date (without extensions) of the income tax return is after March 14, 1990.

(m) *Restoration of deferred gain on disposition outside group*—(1) *In general.* Except as provided in paragraph (m)(2) of this section, for purposes of §1.1502-13, if property sold or exchanged in an intercompany transaction (or property the basis of which is determined, directly or indirectly, in whole or in part, by reference to the basis of such property) is disposed of outside the group, any remaining deferred gain (and any associated tax consequences) shall be taken into account as if the selling member had disposed of the property at the same time and in the same manner as the property is disposed of outside the group. Notwithstanding the previous sentence, the source and character of the gain to the selling member and the status of the selling member for tax purposes (*e.g.*, as a dealer or non-dealer in the property sold) shall be determined as of the time of the intercompany transaction. Any event requiring the restoration of gain pursuant to §1.1502-13(e) or §1.1502-13(f), as modified by paragraph (f) of this section, is treated as a disposition outside the group.

(2) *Exception.* Paragraph (m)(1) of this section does not apply, and §1.1502-13(e) and §1.1502-13(f), as modified by paragraph (f) of this section, apply to the extent that gain or loss is not recognized in a transaction in which property, which was sold or exchanged in an intercompany transaction, (or property the basis of which is determined, directly or indirectly, in whole or in part, by reference to such property) is disposed of outside the group. However, to the extent gain or loss is recognized in such transaction, paragraph (m)(1) of this section applies.

(3) *Examples.* The application of this paragraph (m) is illustrated by the following examples.

Example (1). (i) Corporations P and S file consolidated returns on a calendar year basis. P regularly sells real property in the ordinary course of business. In 1990, P sells nondepreciable real property with a basis of $7,000 to S for $10,000 and P recognizes $3,000 of gain, all of which is deferred under §1.1502-13(c).

(ii) In 1991, S, which does not regularly sell real property in the ordinary course of business, sells the real property to X, an unrelated third party, for a $12,000 obligation, bearing interest at the applicable federal rate and payable in two equal annual installments of $6,000 in 1992 and 1993. If, instead of selling the property to S in 1990, P had sold it to X, P would not have been eligible, under section 453(b), to use the installment method of reporting with respect to its $3,000 gain because it was a dealer in real property in 1990. When S sells the real property to X in 1991, P must therefore take into account its entire $3,000 of deferred gain.

Example (2). (i) Corporations P and S file consolidated returns on a calendar year basis. S owns depreciable property described in section 1245 that it purchased for $10 million. At the end of 1989, when S's basis in the property has been reduced to $7 million as a result of depreciation deductions, S sells the property to P for $20 million and recognizes $13 million of gain, $3 million of which is subject to recapture under section 1245. All of the gain is deferred under §1.1502-13(c).

(ii) At the end of 1990, P sells the property to X, an unrelated third party, for a $25 million obligation, bearing interest at the applicable federal rate and payable in two equal annual installments of $12.5 million in 1991 and 1992. Without regard to depreciation in 1990, P realizes $5 million of gain, which it reports on the installment method under section 453. If, instead of selling the property to P, S had sold it to X in an installment sale, S would have been required to report under section 453(i) the $3 million of recapture income. When P sells the property to X, S must therefore take into account $3 million of deferred gain that is subject to recapture under section 1245.

(iii) Under §1.1502-13(e)(2), S takes into account the $10 million of deferred gain not subject to recapture as P receives the installment payments. Thus, P recognizes $2.5 million of gain under section 453, and S takes into account $5 million of its deferred gain, in each of 1991 and 1992. Section 453A requires interest to be paid on a group's tax liability deferred by reason of section 453 if the installment obligations of the group (and related persons) outstanding at the close of the group's taxable year exceed an aggregate face amount of $5 million. Because the aggregate face amount of the group's installment obligations, $25 million, exceeds $5 million, the deferred tax liabilities of both P and S must be taken into account in determining the interest charge under section 453A beginning with the taxable year in which P's sale occurs.

Example (3). (i) Corporations P, S and T file consolidated returns on a calendar year basis. S holds nondepreciable property A and T holds nondepreciable property B. Properties A and B each have a basis of $1,000 and a fair market value of $10,000. In 1989, T sells property B to P for $10,000. T recognizes $9,000 of gain in 1989 on its sale of property B to P, all of which is deferred under §1.1502-13(c). Under §1.1502-31(a), P's basis in property B is $10,000.

(ii) In 1991, P and S exchange property A and property B in an exchange that qualifies for nonrecognition of gain or loss under section 1031 with respect to both P and S. P does not recognize gain or loss on the exchange, and P's basis in property A is $10,000.

(iii) In 1993, in a transaction to which sections 1031(f) and (g) do not apply, P sells property A to X, an unrelated third party, for $10,000. P realizes no gain on the sale of property A to X. T is required to take into account the $9,000 of deferred gain with respect to property B in 1993, because property A (the basis of which is determined by reference to the basis of property B) was disposed of outside the group.

(4) *Effective date*—(i) *In general.* Except as provided in paragraph (m)(4)(ii) of this section, this paragraph (m) applies to dispositions (as described in this paragraph) of property in taxable years for which the due date (without extensions) of the income tax return is after March 14, 1990.

(ii) *Exception.* Notwithstanding paragraph (m)(4)(i) of this section, this paragraph (m) does not apply to deferred gain taken into account on a disposition of property before March 9, 1990, if the gain was deferred in an intercompany transaction—

(A) after December 31, 1988, provided that, at the time of the intercompany transaction, there was no plan or intention to dispose of the property outside the group and the taxpayer files a separate statement with the taxpayer's return for the taxable year in which such property is disposed of disclosing—

(*1*) a description of the transferred property and the dates of the intercompany transaction and the disposition,

(*2*) the name and employer identification number (E.I.N.) of the member disposing of the property and the amount realized and gain realized by such member on the disposition, and

(*3*) the amount realized and gain realized by the selling member on the intercompany transaction with respect to the property and the name and E.I.N. of the selling member; or

(B) before January 1, 1989.

(n) *Exception to deferral rules*—(1) *In general.* Section 1.1502-13(c) shall not apply to defer gain or loss with respect to a sale or exchange in an intercompany transaction of property to the extent the gain (or loss) is attributable to any income and expense (i) accounted for (or required to be accounted for) by the selling member in accordance with the percentage of completion method and (ii) arising from any activity performed by the selling member for the benefit of, or by reason of, a long term contract between a member and a person not a member that is accounted for by such member, in whole or

part, under the percentage of completion method.

(2) *Example.* This paragraph (n) is illustrated by the following example.

Example. (i) Corporations P and S file consolidated returns on a calendar year basis. In 1990, P enters into a contract with X, a person not a member of the group, for the manufacture and sale of 5 airplanes for a total contract price of $500 million. The contract is a long term contract within the meaning of section 460(f) and P is required to account for income and expense attributable to the contract under the percentage of completion method. By reason of the contract, S manufactures and sells engines for the airplanes to P for a total price of $50 million. S begins to manufacture the engines in 1991 and delivers them in 1992. In 1991, S incurs $20 million out of total estimated costs of $40 million, and, in 1992, S incurs an additional $20 million of costs to complete manufacture of the engines. S accounts for income and expense attributable to the production of the engines pursuant to the percentage of completion method.

(ii) S's sale of the engines to P is a deferred intercompany transaction. However, §1.1502-13(c) does not apply to defer gain attributable to the income and expense accounted for by S under the percentage of completion method. Under the percentage of completion method, S takes into account $20 million in costs and $25 million in income in each of 1991 and 1992.

(3) *Effective date.* This paragraph (n) applies to intercompany transactions in taxable years for which the due date (without extensions) of the income tax return is after March 14, 1990, that are attributable to long term contracts entered into by a member after June 20, 1988.

(o) *References.* A reference in this part to §1.1502-13 is treated as including a reference to this section.

Par. 4. Section 1.1502-14 is amended by adding the words "or after March 14, 1990" immediately following the word "1988" in paragraph (c)(3).

Par. 5. Section 1.1502-14T is amended as follows:

1. The last sentence of paragraph (a) is revised to read as follows: Such deferred gain or loss shall be taken into account at the time and in the manner specified in §1.1502-13(d), (e), and (f), and §1.1502-13T(l) and (m), as if such distributing corporation were a "selling member," the distributee were a "purchasing member" and the distribution described in §1.1502-14 were a "deferred intercompany transaction."

2. The last sentence of paragraph (b) is removed.

3. New paragraphs (c) and (d) are added to read as follows:

§1.1502-14T Treatment of distributing corporation (temporary).

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(c) *Limitation on application of this section*—§1.1502-13, §1.1502-13T and §1.1502-14, gain deferred with respect to a distribution of stock of a subsidiary from one member to another member shall be taken into account (i) upon a disposition (as defined in §1.1502-19(b)(2)) of the stock of the subsidiary in an amount equal to the amount that would have created or increased the excess loss account if the adjustment to the basis (or the excess loss account) of the stock of the subsidiary resulting from the distribution had not occurred, or (ii) following a disposition, to the extent distributions with respect to any stock owned by a member would exceed the basis of such stock if the adjustment to the basis of the stock resulting from the distribution had not occurred.

(2) *Examples.* This paragraph (c) is illustrated by the following examples.

Example (1). (i) Corporation P, S, and T file consolidated returns on a calendar year basis. P owns all 100 shares of the outstanding stock of S. S owns all 200 shares of the outstanding stock of T. The T shares have an adjusted basis of $1,000 and a value of $10,000. S distributes all of its T stock to P. As a result of the distribution, S recognizes $9,000 of gain under section 311(b) and the gain is deferred under paragraph (a) of this section. P receives a $10,000 basis in the T stock under §1.1502-31(a).

(ii) T borrows $9,000 in 1989 and distributes the $9,000 to P in the same year. T has no current earnings and profits, and the distribution reduces P's basis in the T stock from $10,000 to $1,000. In 1990, T has $1000 of earnings and profits which are not distributed. At the end of 1990, T issues 100 shares of stock to X, an unrelated third party. As a result, P no longer owns 80 percent or more of the stock of T and T ceases to be a member of the group. T's ceasing to be a member of the group constitutes a disposition of the T stock under §1.1502-19(b)(2)(i). If the basis of the T stock had not been adjusted as a result of S's distribution of the T stock to P, the $9,000 distribution to P would have resulted in an $7,000 excess loss account with respect to the T stock. Accordingly, S is required to take into account $7,000 of deferred gain (the amount that would have been in the excess loss account but for the adjustment to the basis of the T stock resulting from its distribution).

Example (2). The facts are the same as in Example (1) except that T borrows and distributes the $9,000 to S before S distributes the T stock to P. The results are the same as in Example (1) because P would have had an excess loss account of $7,000 with respect to the T stock at the time T ceased to be a member of the P group but for the adjustment to the excess loss account resulting from S's distribution of the T stock to P.

(3) *Effective date.*—(i) *In general.* Except as provided in paragraph (c)(3)(ii) of this section, this paragraph (c) applies to dispositions (as defined in this paragraph (c)) of stock of a subsidiary in taxable years for which the due date (without extensions) of the income tax return is after March 14, 1990.

(ii) *Exception.* Notwithstanding paragraph (c)(3)(i) of this section, this paragraph (c) does not apply to gain deferred with respect to a distribution of stock of a subsidiary from one member to another member before January 1, 1989, if the disposition (as defined in this paragraph (c)) of the stock of the subsidiary occurs before March 9, 1990.

(d) *References.* A reference in this part to §1.1502-14 is treated as including a reference to this section.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. It is therefore found impracticable and contrary to the public interest to issue this Treasury decision with notice and public procedure under section 553(b) of Title 5 of the United States Code or subject to the effective date limitations of section 553(d) of Title 5 of the United States Code.

Charles H. Brennan,
Acting Commissioner of Internal Revenue.

Approved March 5, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 9, 1990, 2:14 p.m., and published in the issue of the Federal Register for March 14, 1990, 55 F.R. 9420)

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26 CFR 1.1502-13: Intercompany transactions.

Guidelines are set forth regarding the disallowance, under section 265(b) of the Code, of interest expense allocable to tax-exempt obligations held by financial institutions. See Rev. Rul. 90-44, page 54.

Subtitle B.—Estate and Gift Taxes
Chapter 11.—Estate Tax
Subchapter A.—Estates of Citizens or Residents
Part II.—Credits Against Tax

Section 2013.—Credit for Tax on Prior Transfers

26 CFR 20.2013-3: "Second limitation".

Applicable marital deduction in determining "second limitation" on credit for tax on prior transfers. In determining the "second limitation" on the credit for tax on prior transfers for a decedent who died after 1981, the applicable marital deduction is the value of the property passing to the surviving spouse without any proportionate reduction and without limitation as to amount. Rev. Ruls. 60–161, 76–311, and 80–210 are obsolete for decedents dying after 1981.

Rev. Rul. 90–2

ISSUE

In determining the "second limitation" on the credit for tax on prior transfers under section 2013(c)(1) of the Internal Revenue Code for a decedent who died after 1981, what is the applicable marital deduction used in computing the estate tax on the reduced gross estate, under the circumstances described below?

FACTS

D died in July 1986, survived by a spouse, *S*. The value of *D*'s gross estate is $3,300,000 and deductions for debts and expenses in the amount of $200,000 are allowable. *D* bequeathed to *S* the residue of the estate, an amount equal to $2,400,000. A marital deduction is allowable for that amount. The estate claimed a credit for tax on prior transfers under section 2013 of the Code based on a transfer of $500,000 that *D* received from the estate of *D*'s parent, who died in 1984.

LAW AND ANALYSIS

Section 2013 of the Code provides, in general, that a transferee's estate is allowed a credit for estate tax paid with respect to property transferred to the transferee from a transferor who died within ten years before, or within two years after, the transferee's death ("the transferred property"). Under section 2013, the amount of the credit that may be taken by the transferee's estate with respect to the transferred property is subject to two limitations. The "first limitation" is the estate tax attributable to the transferred property in the estate of the transferor. The "second limitation," which is under consideration here, is the estate tax attributable to the transferred property in the estate of the transferee decedent.

The "second limitation," as prescribed in section 2013(c)(1) of the Code and section 20.2013–3 of the regulations, provides that the credit shall not exceed the amount by which (A) the transferee's estate tax, computed after the allowance of all credits except the credit for tax on prior transfers, exceeds (B) such tax computed by excluding from the transferee's gross estate the value of the transferred property.

Section 2056 of the Code provides, with certain limitations, a deduction from the value of the gross estate for the value of the property that passes from the decedent to the surviving spouse.

For decedents dying before 1977, former section 2056(c) of the Code provided that the amount of the marital deduction was limited to one-half of the value of the adjusted gross estate. The Tax Reform Act of 1976, Pub. L. 94–455, 1976–3 C.B. (Vol. 1), 330, amended section 2056(c) for estates of decedents dying after December 31, 1976, to provide generally that the marital deduction shall not exceed the greater of $250,000 or one-half of the adjusted gross estate.

The Economic Recovery Tax Act of 1981, Pub. L. 97–34, 1981–2 C.B. 256, 342, repealed section 2056(c) of the Code for estates of decedents dying after December 31, 1981. Accordingly, for decedents dying after December 31, 1981, the amount of the marital deduction is unlimited.

Rev. Rul. 60–161, 1960–1 C.B. 367, provides (for estates of decedents dying before January 1, 1977) that in computing the estate tax under section 2013(c)(1)(B) on the gross estate as reduced by the value of the transferred property ("reduced gross estate"), the applicable marital deduction is the value of the property passing to the surviving spouse without any proportionate adjustment to reflect the reduction in the gross estate attributable to the transferred property, but is not to exceed one-half of the adjusted gross estate as reduced by the value of the transferred property ("reduced adjusted gross estate"). See also Rev. Rul. 76–311, 1976–2 C.B. 261, which explains how the marital deduction under section 2013(c)(1)(B) is determined for estates that include community property.

Rev. Rul. 80–210, 1980–2 C.B. 251, provides that, in determining the credit for tax on prior transfers under the "second limitation" of section 2013(c)(1) of the Code, for purposes of computing the tax on the reduced gross estate of a decedent who died after 1976 (and before 1982), the applicable marital deduction is the value of the property actually passing to the surviving spouse, but not to exceed the greater of $250,000 or one-half of the reduced adjusted gross estate.

With the repeal of section 2056(c) for estates of decedents dying after December 31, 1981, section 2056 no longer contains a limitation on the amount of the marital deduction that would be applicable in determining the value of the reduced taxable estate under section 2013(c)(1)(B).

Accordingly, in computing the estate tax on the reduced gross estate in accordance with section 2013(c)(1)(B) of the Code, for estates of transferees dying after December 31, 1981, the applicable marital deduction is the value of the property passing to the surviving spouse without any proportionate reduction and without limitation as to amount.

HOLDING

In determining the "second limitation" on the credit for tax on prior transfers under section 2013(c)(1) of the Code, the marital deduction allowable in computing the estate tax under section 2013(c)(1)(B) under the facts of this ruling is $2,400,000.

EFFECT ON OTHER DOCUMENTS

The limitations in the marital deduction for purposes of the computation under section 2013(c)(1)(B) set forth in Rev. Rul. 60–161, Rev. Rul. 76–311, and Rev. Rul. 80–210 are declared obsolete for decedents dying after 1981.

Part III.—Gross Estate

Section 2032A.—Valuation of Certain Farm, etc., Real Property

26 CFR 20.2032A–3.: Material participation requirements for valuation of certain farm and closely-held business real property.

Are selling expenses and late-payment interest on additional estate tax imposed as a result of a disposition of qualified real property deductible as necessary administration expenses under section 2053(a)(2) of the Code in computing the taxable estate of the decedent. See Rev. Rul. 90-8, page

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26 CFR 20.2032A-4: Method of valuing farm real property.

Special use value; farms; interest rates. The 1990 interest rates to be used in computing the special use value of farm real property for which an election is made under section 2032A of the Code are listed for estates of decedents.

Rev. Rul. 90-49

This revenue ruling contains a list of the average annual effective interest rates on new loans under the Farm Credit Bank system. (Prior to 1988, the Farm Credit Banks were known as Federal Land Banks. As a result of the Agriculture Credit Act of 1987, Pub. L. No. 100-233, each Federal Land Bank merged into a newly created Farm Credit Bank.) This revenue ruling also contains a list of the states within each Farm Credit Bank District.

Under section 2032A(e)(7)(A)(ii) of the Internal Revenue Code, rates on new Farm Credit Bank loans are used in computing the special use value of real property used as a farm for which an election is made under section 2032A. The rates in this revenue ruling may be used by estates that value farmland under section 2032A as of a date in 1990.

Average annual effective interest rates, calculated in accordance with section 2032A(e)(7)(A) of the Code and section 20.2032A-4(e) of the Estate Tax Regulations, to be used under section 2032A(e)(7)(A)(ii), are set forth in the accompanying Table of Interest Rates (Table I). The states within each Farm Credit Bank District are set forth in the accompanying Table of Farm Credit Bank Districts (Table II).

Rev. Rul. 81-170, 1981-1 C.B. 454, contains an illustrative computation of an average annual effective interest rate. The rates applicable for valuation in 1989 are in Rev. Rul. 89-58, 1989-1 C.B. 275. For rate information for years prior to 1989, see Rev. Rul. 88-59, 1988-2 C.B. 332, and other revenue rulings that are cited therein.

REV. RUL. 90-49 TABLE 1

TABLE OF INTEREST RATES
(Year of Valuation 1990)

Farm Credit Bank District in which property is located	
Baltimore	11.13
Columbia	11.52
Louisville	11.98
Omaha	11.59
Sacramento	11.87
St. Louis	11.18
St. Paul	11.60
Spokane	11.59
Springfield	11.34
Texas	11.22
Wichita	11.39

REV. RUL. 90-49 TABLE 2

TABLE OF FARM CREDIT BANK DISTRICTS

District	States
Baltimore	Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia.
Columbia	Florida, Georgia, North Carolina, South Carolina.
Louisville	Indiana, Kentucky, Ohio, Tennessee.
Omaha	Iowa, Nebraska, South Dakota, Wyoming.
Sacramento	Arizona, California, Hawaii, Nevada, Utah.
St. Louis	Arkansas, Illinois, Missouri.
St. Paul	Michigan, Minnesota, North Dakota, Wisconsin.
Spokane	Alaska, Idaho, Montana, Oregon, Washington.
Springfield	Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont.
Texas	Alabama, Louisiana, Mississippi, Texas.
Wichita	Colorado, Kansas, New Mexico, Oklahoma.

Section 2035.—Adjustments for Gifts Made Within 3 Years of Decedent's Death

26 CFR 20.2035-1: Transactions in contemplation of death.
(Also Section 2042; 20.2042-1.)

Insurance gift; transfer. The gratuitous assignment of a life insurance policy by a corporation within three years of the death of the corporation's controlling shareholder is, for purposes of section 2035(d)(2) of the Code, a transfer of the incidents of ownership in the policy by the controlling shareholder.

Rev. Rul. 90-21

ISSUES

(1) If, within 3 years of its controlling shareholder's death, a corporation, for less than adequate and full consideration, assigns a life insurance policy on the stockholder's life and the stockholder then disposes of control of the corporation and if the life insurance proceeds are payable to a third party for other than a business purpose described in section 20.2042-1(c)(6) of the Estate Tax Regulations, are the insurance proceeds includible in the deceased stockholder's gross estate under section 2035 of the Internal Revenue Code?

(2) If, within 3 years of death, a stockholder, for less then adequate and full consideration, disposes of the controlling interest in a corporation that owns a life insurance policy on the stockholder's life, and if the life insurance proceeds are payable to a third party for other than a business purpose within the meaning of section 20.2042-1(c)(6) of the regulations, are the insurance proceeds includible in the deceased stockholder's gross estate under section 2035 of the Code?

FACTS

Situation 1: *D* owned 80 percent of the voting stock of *X* corporation. In 1982, *X* corporation acquired a life insurance policy on *D*'s life payable to *D*'s child *B*. In 1986, *X* corporation assigned the policy to *B* for less than adequate and full consideration. In 1987, *D* transferred *D*'s 80 percent interest in *X* corporation to *D*'s child *C*. *D* died in 1988, and the proceeds of the policy were paid to *B*.

Situation 2: The facts are the same as in Situation 1, except that (i) *X* corporation retained ownership of the life insurance policy, and (ii) in 1987, *D* transferred to *C* 40 percent of the shares of *X*.

LAW AND ANALYSIS

Section 2033 of the Code provides that the value of the gross estate includes the value of all property to the extent of the interest therein of the decedent at the time of death. This section applies to all property beneficially owned by the decedent at death.

Section 2035(a) of the Code provides that the gross estate includes the value of all property to the extent of any interest therein of which the decedent has made a transfer within 3 years of death. The Economic Recovery Tax Act of 1981, Section 424(a), 1981-2 C.B. 256, 332, added section 2035(d) to the Code. Section 2035(d)(1) generally limits the application of section 2035(a) to estates of decedents dying before 1982. However, certain transfers by decedents dying after 1981 remain subject to the 3-year inclusion rule. Under section 2035(d)(2), section 2035(a) applies to a transfer of an interest in property which is included in the value of the gross estate under section 2036, 2037, 2038 or 2042 or would have been included under any of those sections if the interest had been retained by the decedent until death.

Section 2042(2) of the Code provides that the value of the gross estate includes the value of the amount receivable as insurance under policies on the life of the decedent by beneficiaries other than the executor, with respect to which the decedent possessed at death any of the incidents of ownership, exercisable alone or in conjunction with any other person.

Section 20.2042-1(a)(2) of the regulations provides that proceeds of life insurance that are not includible in the gross estate under section 2042 of the Code may, depending upon the facts of a particular case, be includible under some other section of the estate tax provisions of the Code. For example, if the decedent possessed incidents of ownership in an insurance policy on the decedent's own life and gratuitously transferred all rights in the policy within 3 years of death, the proceeds would be includible under section 2035.

Section 20.2042-1(c)(6) of the regulations describes the degree of voting control over a corporation that is necessary to constitute incidents of ownership in a life insurance policy owned by the corporation. The regulation explains that, if a decedent is the controlling stockholder in a corporation that holds a life insurance policy on the decedent's life, and the proceeds of the policy are payable to a third party for nonbusiness purposes, the incidents of ownership held by the corporation will be attributed to the decedent through the decedent's stock ownership and the proceeds will be included in the decedent's gross estate under section 2042 of the Code. For this purpose, a controlling stockholder is one who owns stock possessing more than 50 percent of the total combined voting power of a corporation at death.

Includibility of life insurance proceeds under section 2042 of the Code depends on the decedent's possession of incidents of ownership of the policy at death. However, includibility of life insurance proceeds under section 2035(d)(2) is based on a different rule. Section 2035(d)(2) will apply if the decedent transferred an incident of ownership in the life insurance policy during the 3-year period before death.

Rev. Rul. 82-141, 1982-2 C.B. 209, considers whether the value of life insurance proceeds is includible in a decedent's gross estate under section 2035 of the Code. In 1980, within 3 years of the decedent's death, the decedent's controlled corporation had transferred ownership of a policy on the decedent's life. The decedent owned more than 50 percent of the voting stock in the corporation at the time the policy was transferred. The ruling states that "the principle underlying the attribution rule of section 20.2042-1(c)(6) of the regulations mandates that the incidents of ownership possessed by *X* [the controlled corporation] be attributed to *D* [the decedent] for purposes of section 2035 of the Code." See 1982-2 C.B. at 209. The ruling holds that the entire value of the insurance proceeds is includible in *D*'s gross estate.

In Situation 1, as in Rev. Rul. 82-141, *X* corporation's transfer of the incidents of ownership of the policy is attributable to *D* because *D* owned the controlling interest in *X*

corporation at the time of the transfer. The subsequent disposition of the controlling interest does not affect the analysis in Rev. Rul. 82-141 that *D* is treated as having transferred the incidents of ownership within 3 years of *D*'s death. Accordingly, the value of the policy proceeds is includible in *D*'s gross estate under sections 2035(a) and 2035(d)(2).

In Situation 2, a similar rationale applies. The incidents of ownership in a life insurance policy on *D*'s life were transferred within 3 years of *D*'s death, within the meaning of section 2035(d)(2) of the Code, as a result of the transfer of 40 percent of the stock of *X* corporation. Although the policy itself was not transferred as in Situation 1, the result is the same. As a result of the transfer of stock, *D* no longer held a controlling interest in *X* corporation. *D* thereby effectively released the incidents of ownership in the policy attributed to *D* as the controlling shareholder and such release is a transfer within the meaning of section 2035(d)(2). Accordingly, the value of the policy proceeds is includible in *D*'s gross estate under sections 2035(a) and 2035(d)(2).

HOLDINGS

(1) Life insurance proceeds are includible in a deceased stockholder's gross estate under section 2035 of the Code if, within 3 years of death, the corporation, for less than adequate and full consideration, assigns an insurance policy on the stockholder's life and the stockholder then disposes of control of the corporation and if the life insurance proceeds are payable to a third party for other than a business purpose within the meaning of section 20.2042-1(c)(6) of the regulations.

(2) Life insurance proceeds are includible in a deceased stockholder's gross estate under section 2035 of the Code if, within 3 years of death, the stockholder, for less than adequate and full consideration, disposes of the controlling interest in a corporation that owns a life insurance policy on the stockholder's life and if the life insurance policy proceeds are payable to a third party for other than a business purpose within the meaning of section 20.2042-1(c)(6) of the regulations.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 82-141 is amplified.

Section 2042.—Proceeds of Life Insurance

26 CFR 20.2042-1: Proceeds of life insurance.

If, within 3 years of its controlling stockholder's death, a corporation gratuitously assigns a life insurance policy on the stockholder's life and the stockholder then disposes of control and if the proceeds are payable to a third party, are the proceeds includible in the gross estate under section 2035(d)(2)? See Rev. Rul. 90-21, page 172.

Part IV.—Taxable Estate

Section 2053.—Expenses, Indebtedness and Taxes

26 CFR 20.2053-3: Deductions for expenses of administering estate.
(Also Section 2032A; 20.2032A-3.)

Deductibility of sales expenses and late-payment interest on additional estate tax. In the case of a special use valuation election where the qualified heir disposes of a portion of the qualified real property neither the sales expenses incurred in selling the property nor the interest expense incurred as a result of the late payment of the additional estate tax is deductible under section 2053(a)(2) of the Code in computing the decedent's taxable estate. Rev. Rul. 81-154 distinguished.

Rev. Rul. 90-8

ISSUE

If, after a decedent's estate has made a special use valuation election under section 2032A of the Internal Revenue Code, the qualified heir disposes of a portion of the qualified property to a person who is not a member of the family of the qualified heir and the qualified heir incurs sales expenses and late-payment interest on the additional estate tax imposed by section 2032A(c), are the sales expenses incurred in selling the property and the interest on the additional tax deductible under section 2053(a)(2) in computing the decedent's taxable estate?

FACTS

D owned and operated a farm for several years prior to *D*'s death in 1985. *D* devised the farm to *D*'s child, C. *D*'s executor, *E*, made an election on *D*'s timely filed estate tax return to specially value *D*'s farm real property under section 2032A of the Code. Pursuant to the requirements of section 2032A(d), *C* as a qualified heir signed an agreement to be liable for any additional estate tax that might be imposed under section 2032A(c).

Although the administration of *D*'s estate was expected to continue for 3 or 4 years, *C* acquired legal title to the property 1 year after *D*'s death. For reasons unrelated to the administration of the estate, *C* sold a portion of the farm property in 1987 to a person who, for purposes of section 2032(c)(1)(A) of the Code, was not a member of *C*'s family. *C* incurred selling expenses in connection with the sale of the property and received the net proceeds. The sale was a disposition of qualified real property for purposes of section 2032A(c)-(1)(A) and, as a result, an additional estate tax was imposed under that section. Although under section 2032A(c)(4) the additional estate tax is required to be paid within 6 months after the date of the disposition, the tax was not paid by *C* until one year after the due date. Consequently, *C* was required to pay interest on the additional estate tax for the one-year period after the due date.

LAW AND ANALYSIS

Section 2032A of the Code permits an executor, in determining the value of a decedent's gross estate, to elect to value qualified real property (as defined in section 2032A(b)(1)) that passes to a qualified heir (as defined in section 2032A(e)(1)) on the basis of its qualified use in farming or a trade or business other than farming rather than on the basis of its highest and best use, under certain specific conditions and subject to certain limitations.

Under section 2032A(d) of the Code and section 20.2032A-8(c)(1) of the regulations, the qualified heir must sign an agreement consenting to liability for the additional tax that is imposed under the circumstances that are described in section 2032A(c). Under that section if the property ceases to be used as a farm or in another trade or business or is disposed of by the heir to a nonfamily member with-

in 10 years after the death of the decedent, but before the death of the heir, all or a portion of the estate tax benefits obtained from the executor's earlier election to use the section 2032A special use valuation must be recaptured in the form of an additional estate tax imposed on the qualified heir.

Section 2032(c)(4) of the Code provides that the additional tax imposed on the qualified heir will become due and payable 6 months after the property is disposed of or ceases to be used as a farm or in another trade or business. Under section 6601(a), if any amount of tax is not paid on or before the last day fixed for payment, interest must be paid at the established annual rate for the period from the last day fixed for payment to the date paid. Thus, under section 6601(a), interest on the additional tax runs from the date that is 6 months after the date of disposition of the property or cessation of the qualified use until the date of payment. See Rev. Rul. 81-308, 1981-2 C.B. 176.

Section 2053(a)(2) of the Code provides that the value of the taxable estate is determined by deducting from the value of the gross estate administration expenses to the extent the expenses are allowable under the laws of the jurisdiction in which the estate is being administered.

Section 20.2053-3(a) of the Estate Tax Regulations provides in part that the expenses deductible under section 2053(a)(2) of the Code are only those that are actually and necessarily incurred in the administration of an estate and in the transfer of the property of the estate to individual beneficiaries or to a trustee. Expenditures not essential to the proper settlement of the estate but incurred for the individual benefit of the heirs, legatees or devisees are not deductible.

Section 20.2053-3(d)(2) of the regulations provides that expenses for selling property of the estate are deductible if the sale is necessary in order to pay the decedent's debts, expenses of administration, or taxes, to preserve the estate, or to effect distribution. The phrase "expenses for selling property" include brokerage fees and other necessary expenses attending the sale.

In *United States v. Stapf*, 375 U.S. 118 (1963), the Supreme Court held that expenses allocable to the surviving spouse's share of community property were not deductible as administration expenses under the predecessor of section 2053 of the Code even though the decedent's will directed that these amounts should be paid by the estate.

In Rev. Rul. 81-154, 1981-1 C.B. 470, the Service held that interest on the federal estate tax liability of a decedent's estate is a necessary administration expense under section 2053(a)(2) of the Code and is deductible to the extent allowable under local law, irrespective of the reason the estate incurred the interest expense.

In the present case, the sale of the property by *C* was not necessary to the administration of *D*'s estate. The expenses were incurred by *C*, not *D*'s estate. Under section 20.2032A-8-(c)(1) of the regulations, *C* signed an agreement to be personally liable for additional tax in the event of an early disposition of qualified property. The additional tax and the interest thereon were imposed on *C* and not on *D*'s estate.

No expense is deductible as an administration expense under section 2053(a)(2) of the Code unless it is actually and necessarily incurred in the administration of the estate. Thus, neither the sales expenses incurred by *C* nor the interest imposed on *C* is deductible under section 2053(a)(2).

Rev. Rul. 81-154 is distinguished because the interest expense in that ruling was interest on a tax imposed on the estate. Here the interest is on a tax imposed on the qualified heir.

HOLDING

If, after a decedent's estate has made a special use valuation election under section 2032A of the Code, the qualified heir disposes of a portion of the qualified property to a person who is not a member of the family of the qualified heir and the qualified heir incurs sales expenses and late-payment interest on the additional estate tax imposed by section 2032A(c), neither the sales expenses nor the interest on the additional tax is deductible under section 2053(a)(2) in computing the decedent's taxable estate.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 81-154, 1981-1 C.B. 470 is distinguished.

Section 2055.—Transfers for Public, Charitable, and Religious Uses

26 CFR 20.2055-2: Transfers not exclusively for charitable purposes.

Contributions to a qualifying charitable remainder unitrust that meets the requirements of section 664(d)(2) of the Code and provides for unitrust payments for one or two measuring lives are deductible for estate tax purposes, assuming that all other applicable requirements for a charitable contribution are met. See Rev. Proc. 90-30, page 534.

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26 CFR 20.2055-2: Transfers not exclusively for charitable purposes.

Contributions to a qualifying charitable remainder unitrust that meets the requirements of section 664(d)(2) and (3) of the Code and provides for unitrust payments for one or two measuring lives are deductible for estate tax purposes, assuming that all other applicable requirements for a charitable contribution are met. See Rev. Proc. 90-31, page 539.

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26 CFR 20.2055-2: Transfers not exclusively for charitable purposes.

Contributions to a qualifying charitable remainder unitrust that meets the requirements of section 664(d)(1) of the Code and provides for annuity payments for one or two measuring lives are deductible for estate tax purposes, assuming that all other applicable requirements for a charitable contribution are met. See Rev. Proc. 90-32, page 546.

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26 CFR 20.2055-2: Transfers not exclusively for charitable purposes.

The Service ordinarily will not issue rulings as to whether a transfer to charitable remainder trust described in section 664 of the Code that provides for annuity or unitrust payments for one or two measuring lives qualifies for a charitable deduction under section 2055(e)(2)-(A) of the Code. See Rev. Proc. 90-33, page 551.

Section 2056.—Bequests, Etc., To Surviving Spouse

25 CFR 20.2056(b)-1: Marital deduction; limitation in case of life estate or other "terminable interests."

Residuary bequest to spouse; pecuniary bequest payable at fair market value. A residuary bequest to the

surviving spouse is deductible for purposes of section 2056 of the Code where the beneficiary of a pecuniary bequest is required to be paid with assets valued at their fair market at the time of payment. Rev. Rul. 81-20 clarified.

Rev. Rul. 90-3

ISSUE

If a decedent's will provides for a pecuniary bequest that is required to be paid on the basis of fair market value of assets at the time of payment, does the possibility that post death fluctuations in the value of estate assets may significantly diminish the residuary bequest to the surviving spouse cause the residuary bequest to be a nondeductible terminable interest for purposes of section 2056(b) of the Internal Revenue Code?

FACTS

D, a resident of State *X* died on March 1, 1987. At the time of *D*'s death, *D*'s gross estate had a fair market value of $900,000. Debts of the decedent and expenses of administering the estate totaled $50,000. *D*'s will provides for a bequest in the amount of $600,000 to *D*'s child, *C*, and gives the residue of *D*'s estate to *D*'s surviving spouse, *S*. The will empowers the executor to satisfy the $600,000 pecuniary bequest in cash or in kind or by a combination of both. The executor is required under applicable local law to value assets selected to satisfy the bequest at their fair market value as of the date of distribution.

During October 1987, the value of the assets comprising *D*'s gross estate abruptly declined from approximately $900,000 to $700,000 and remained in the range of $680,000 to $710,000 until the estate was finally settled and its assets distributed on January 18, 1989. After paying the debts and administration expenses and distributing cash and other property worth $600,000 in payment of the bequest to *C*, the executor distributed the residue of the estate to *S*. The value of the distribution to *S* was $55,000 rather than the $250,000 value of the residue at the time of *D*'s death.

LAW AND ANALYSIS

Section 2056(a) of the Code provides that, for purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by section 2056(b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to the surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

Section 2056(b) of the Code places a limitation on the allowability of the marital deduction in the case of a life estate or other terminable interest.

Section 20.2056(b)-1(b) of the Estate Tax Regulations provides that a "terminable interest" in property is an interest that will terminate or fail upon the lapse of time or upon the occurrence or the failure to occur of some contingency. Life estates, terms for years, annuities, patents, and copyrights are terminable interests. However, a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity or a term for years, is not a terminable interest.

Section 20.2056(e)-1 of the regulations generally provide that any property interest bequeathed or devised by the decedent or inherited from the decedent is considered as having passed to the person to whom the decedent bequeathed or devised the interest or to the person who inherited the interest from the decedent.

In cases where a pecuniary bequest may be paid or satisfied with noncash assets on the basis of the fair market value of such assets as determined at a time prior to payment, the value of the payment may differ from the amount of the bequest. For example, if noncash assets used to pay such a bequest have declined in value between the valuation date and the payment date, the fair market value of the payment would be less than the amount of the pecuniary bequest. See Rev. Proc. 64-19, 1964-1 C.B. 682, which explains that a marital deduction may be disallowed if a pecuniary bequest is to be satisfied with noncash assets on the basis of date of death values of such assets and the executor is under no clear duty to satisfy such bequest with assets that are fairly representative of the appreciation and depreciation of assets available to pay the bequest. Rev. Proc. 64-19 also explains that a marital deduction is ordinarily allowable if a pecuniary bequest to the surviving spouse is to be paid with assets valued on the date of payment.

In the present case, the residuary bequest is considered as having passed from *D* to the surviving spouse within the meaning of section 20.2056(e) of the regulations. The fact that estate assets decline in value before the property is distributed does not affect this conclusion. Further, the residuary bequest is not a "terminable interest" as defined in section 20.2056(b)-1(b).

HOLDING

If a pecuniary bequest is required to be paid with assets valued at the time of payment, the possibility that post death fluctuations in the fair market value of estate assets may diminish the residuary bequest to the surviving spouse does not cause the residuary bequest to be a nondeductible terminable interest for purposes of section 2056(b) of the Code.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 81-20, 1981-1 C.B. 471, concludes that a deduction is allowable under section 2055 of the Code for a residuary bequest to a charity where there was a pecuniary bequest to a child. In reaching this conclusion, Rev. Rul. 81-20 relies, in part, on the executor's obligation under applicable state law to act impartially and fairly with respect to all beneficiaries. Generally, this duty of impartiality and fairness is satisfied if a pecuniary bequest is required to be paid with noncash assets on the basis of the fair market value of such assets on the date of payment, provided that distribution of the assets is not unreasonably postponed. Rev. Rul. 81-20 is clarified.

Chapter 12.—Gift Tax

Subchapter B.—Transfers

Section 2518.—Disclaimers

26 CFR 25.2518-2: Requirements for a qualified disclaimer.

Disclaimer by surviving spouse of elective share. The disclaimer by a

surviving spouse of a portion of the interest acquired as a result of the spouse's exercise of the statutory right of election is a qualified disclaimer if the interest is disclaimed within 9 months of the decedent's death.

Rev. Rul. 90-45

ISSUE

If the surviving spouse elects to take a statutory share in the decedent's estate and subsequently disclaims a portion of the interest, is the surviving spouse's disclaimer a qualified disclaimer under section 2518(a) of the Internal Revenue Code?

FACTS

Situation 1. *A*, a resident of state *X*, died in 1987. *A* was survived by *B*, *A*'s spouse, and *C*, the child of *A* and *B*. Under the terms of *A*'s will, *B*, who was over the age of 21 at the time of *A*'s death, received a pecuniary bequest and certain tangible personal property.

Within 9 months after *A*'s death, *B* filed an election provided under the laws of state *X* to take against *A*'s will. The election entitled *B* to receive that portion of *A*'s estate that *B* would have received had *A* died intestate. Accordingly, *B* became entitled to receive a one-half fee interest in *A*'s estate. Within 9 months after *A*'s death, *B* disclaimed an undivided portion of the elected statutory share. The disclaimer was in writing and as a result of the disclaimer, the disclaimed property passed to *C* without any direction on the part of *B*.

Situation 2. The facts are the same as in *Situation 1*, except that *B* disclaimed the interest within 9 months of filing the election to take against *A*'s will, but more than 9 months after *A*'s death.

LAW AND ANALYSIS

Under section 2518(a) of the Code, if a person makes a qualified disclaimer of any interest in property, for purposes of the estate, gift, and generation-skipping transfer tax provisions, the disclaimed interest is treated as if it had never been transferred to the person making the qualified disclaimer. Instead, the interest disclaimed is treated as passing directly from the transferor of the property to the person entitled to receive the property as a result of the disclaimer.

Section 2518(b) of the Code defines a qualified disclaimer as an irrevocable and unqualified refusal to accept an interest in property where:

(1) the refusal is in writing,

(2) the written disclaimer is received by the transferor of the interest or the legal representative within 9 months after the later of—

(A) the date on which the transfer creating the interest in the person is made, or

(B) the date on which the person attains the age of 21,

(3) the person has not accepted the interest or any of its benefits, and

(4) as a result of the disclaimer, the interest passes without any direction on the part of the person making the disclaimer either—

(A) to the spouse of the decedent, or

(B) to a person other than the person making the disclaimer.

Section 2518(c)(1) provides that a disclaimer of an undivided portion of an interest that meets the requirements of section 2518(b) is treated as a qualified disclaimer of that portion of the interest.

Under section 25.2518-2(c)(1) of the Gift Tax Regulations, a disclaimer satisfies the requirements of section 2518(b)(2)(A) if the disclaimer is delivered within 9 months after the taxable transfer creating the interest. Section 25.2518-2(c)(3) provides that, with respect to transfers made by a decedent at death, the taxable transfer occurs on the date of the decedent's death. The regulation describes a situation where an individual disclaims a specific bequest of property under a will and, as a result of the disclaimer, the property interest passes to the estate residue. The regulation provides that the residuary beneficiary can make a qualified disclaimer of the interest that passes provided the residuary beneficiary disclaims the interest within 9 months after the testator's death, notwithstanding that the disclaimant had no entitlement to the interest until the execution of the first disclaimer.

Section 25.2518-2(d)(1) of the regulations provides that a qualified disclaimer cannot be made with respect to an interest in property if the disclaimant has expressly or impliedly accepted the interest or any of its benefits prior to making the disclaimer. Acceptance is manifested by an affirmative act which is consistent with ownership of the interest in property. Acts indicative of acceptance include using the property or the interest in property, accepting dividends, interest, or rents from the property, and directing others to act with respect to the property or interest in property. However, merely taking delivery of an instrument of title, without more, does not constitute acceptance. Further, a disclaimant is not considered to have accepted property merely because, under applicable local law, title to the property vests immediately in the disclaimant upon the death of the decedent.

In *Situation 1*, *B*'s statutory share election merely effectuated or perfected B's right to receive a portion of the estate. After the election, *B*'s position is precisely the same as it would have been if A had bequeathed the property to *B*, or if *A* had died intestate and the property passed to *B* by operation of law. Consequently, although *B*'s exercise of the election constitutes an affirmative act that vests title to the property in B, it is not an acceptance of the property or its benefits. Accordingly, in *Situation 1*, since *B*'s disclaimer otherwise qualifies under section 2518(b) of the Code, the disclaimer is a qualified disclaimer.

In *Situation 2*, *B* disclaimed the interest within 9 months of exercising the election, but more than 9 months after *A*'s death. Thus, *Situation 2* presents the question whether *B*'s disclaimer is timely.

B did not become entitled to the statutory share until the right of election was exercised. As a result of the election, for transfer tax purposes, *B*'s statutory share is deemed to pass directly from *A* to *B*, as of *A*'s date of death. *See, e.g.*, section 2056(c)(3) of the Code. Accordingly, for purposes of section 2518 of the Code, the taxable transfer creating *B*'s interest occurred on the date of *A*'s death, notwithstanding that *B* was not entitled to receive the interest until *B* exercised the right of election. *See*, section 25.2518-2(c)(3). Accordingly, in *Situation 2*, *B*'s disclaimer is not a

qualified disclaimer under section 2518 because *B* did not disclaim the interest within 9 months after *A*'s death.

HOLDINGS

(1) In *Situation 1*, because the surviving spouse elects to take a statutory share in the decedent's estate and subsequently disclaims a portion of the elective share within 9 months of the date of the decedent's death, the disclaimer is a qualified disclaimer under section 2518 of the Code.

(2) In *Situation 2*, because the surviving spouse elects to take a statutory share and subsequently disclaims a portion of the elective share within 9 months of the election, but more than 9 months after the date of the decedent's death, the disclaimer is not a qualified disclaimer under section 2518 of the Code.

Subchapter C.—Deductions

Section 2522.—Charitable and Similar Gifts

26 CFR 25.2522(c)-3: Transfers not exclusively for charitable, etc. purposes in the case of gifts made after July 31, 1969.

Contributions to a qualifying charitable remainder unitrust that meets the requirements of section 664(d)(2) of the Code and provides for unitrust payments for one or two measuring lives are deductible for gift tax purposes, assuming that all other applicable requirements for a charitable contribution are met. See Rev. Proc. 90-30, page 534.

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26 CFR 25.2522(c)-3: Transfers not exclusively for charitable, etc. purposes in the case of gifts made after July 31, 1969.

Contributions to a qualifying charitable remainder unitrust that meets the requirements of section 664(d)(2) and (3) of the Code and provides for unitrust payments for one or two measuring lives are deductible for gift tax purposes, assuming that all other applicable requirements for a charitable contribution are met. See Rev. Proc. 90-31, page 539.

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26 CFR 25.2522(c)-3: Transfers not exclusively for charitable, etc. purposes in the case of gifts made after July 31, 1969.

Contributions to a qualifying charitable remainder annuity trust that meets the requirements of section 664(d)(1) of the Code and provides for annuity payments for one or two measuring lives are deductible for gift tax purposes, assuming that all other applicable requirements for a charitable contribution are met. See Rev. Proc. 90-32, page 546.

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26 CFR 25.2522(c)-3: Transfers not exclusively for charitable, etc. purposes in the case of gifts made after July 31, 1969.

The Service ordinarily will not issue rulings as to whether a transfer to an inter vivos charitable remainder trust described in section 664 of the Code that provides for annuity or unitrust payments for one or two measuring lives qualifies for a charitable deduction under section 2522(c)(2)(A) of the Code. See Rev. Proc. 90-33, page 551.

Subtitle C.—Employment Taxes

Chapter 21.—Federal Insurance Contributions Act

Subchapter A.—Tax on Employees

Section 3101.—Rate of Tax

26 CFR 31.3101-2: Rates and computation of employee tax.

The adjusted salary of a reemployed federal annuitant is subject to the hospital insurance taxes of sections 3101(b) and 3111(b), but is not subject to the OASDI taxes of sections 3101(a) and 3111(a). See Rev. Rul. 90-32, this page.

Subchapter B.—Tax on Employers

Section 3111.—Rate of Tax

26 CFR 31.3111-2: Rates and computation of employer tax.

The adjusted salary of a reemployed federal annuitant is subject to the hospital insurance taxes of sections 3101(b) and 3111(b), but is not subject to the OASDI taxes of sections 3101(a) and 3111(a). See Rev. Rul. 90-32, this page.

Subchapter C.—General Provisions

Section 3121.—Definitions

26 CFR 31.3121(a)(5)-1: Payments from or to certain tax-exempt trusts or under or to certain annuity plans or bond purchase plans.

The Civil Service annuity received by a reemployed federal annuitant is not subject to the taxes imposed by sections 3101 and 3111. The adjusted salary of the reemployed annuitant is subject to the hospital insurance taxes of sections 3101(b) and 3111(b), but is not subject to the OASDI taxes of sections 3101(a) and 3111(a). See Rev. Rul. 90-32, below.

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26 CFR 31.3121(b)(6)-1: Services in employ of United States or instrumentality thereof.
(Also 31.3121(a)(5)-1.)
(Also Sections 3101, 3111; 31.3101-2, 31.3111-2.)

Reemployed federal annuitant; adjusted salary. The adjusted salary of a reemployed federal annuitant is not subject to the OASDI taxes of sections 3101(a) and 3111(a) of the Code, but is subject to the hospital insurance taxes of sections 3101(b) and 3111(b).

Rev. Rul. 90-32

ISSUE

What portion of the salary of a reemployed federal annuitant is "wages" for purposes of the Federal Insurance Contributions Act (FICA) when the employee's salary is reduced by an amount equal to the amount of the annuity received?

FACTS

A, a federal employee, retired in 1985 and began receiving an annuity from the Civil Service Retirement and Disability Fund (Fund). A was appointed in 1987 to a federal civil service position and continued to receive the annuity. A did not elect to be covered under the Federal Employees Retirement System (FERS) and does not perform any service described in section 3121(b)(5)(C) through (G) of the Internal Revenue Code. Under 5 U.S.C. section 8344(a) (1988), an amount equal to the annuity allocable to the period of reemployment was deducted from A's pay and deposited in the Treasury of the United States.

LAW AND ANALYSIS

Sections 3101(a) and 3111(a) of the Code impose old-age, survivors, and disability insurance taxes on employees and employers, respectively, based on wages "received" or "paid" for employment. Sections 3101(b) and 3111(b) impose hospital insurance taxes on employees and employers, respectively, based on wages "received" or "paid" for employment.

Section 3121(a) of the Code provides that for FICA purposes, the term "wages" means all remuneration for employment, with certain specified exceptions. Section 3121(a)(5) excepts from the definition of "wages" payments such as the annuity received by A from the Fund.

Section 3121(b) of the Code defines "employment" for FICA purposes as any service of whatever nature performed by an employee for the person employing the employee. Section 3121(b)(5)(A) and (B)(ii) generally except from this definition service performed in the employ of the United States by an individual who is receiving an annuity from the Fund.

Section 3121(u)(1) states that the exceptions provided by section 3121(b)(5) shall not apply for purposes of the hospital insurance taxes imposed by sections 3101(b) and 3111(b).

A's remuneration for current services is the salary A would otherwise receive less the reduction prescribed by 5 U.S.C. section 8344(a) (1988) (A's "adjusted salary"). This follows because A, as a federal annuitant, is not entitled to receive the full amount of salary for the civil service position. Instead, A will continue to receive the annuity without reduction during the period of reemployment. *Compare* 5 U.S.C. section 8344(a) (1988) (which reduces the salary of the annuitant, but continues the annuity) *with* 5 U.S.C. section 8344(d) (1988) (which suspends the annuity, but provides that the full salary be paid). This result is further supported by section 3121(b)(5)(B)(ii) of the Code, which recognizes for FICA purposes that an employee of the United States Government may also be receiving an annuity from the Fund. Thus, A is treated as receiving an annuity from the Fund and as receiving the adjusted salary with respect to the services that A is currently performing.

Section 3121(a)(5) of the Code operates to exempt A's annuity both from old-age, survivors, and disability insurance taxes and from hospital insurance taxes. Because A is receiving an annuity from the Fund, section 3121(b)(5) excepts A's adjusted salary from old-age, survivors, and disability insurance taxes. Under section 3121(u), however, this exception does not apply for purposes of the hospital insurance taxes.

HOLDING

The adjusted salary received by A is subject to the hospital insurance taxes imposed by sections 3101(b) and 3111(b) of the Code. No part of A's adjusted salary is subject to the old-age, survivors, and disability insurance taxes imposed by sections 3101(a) and 3111(a), and none of A's annuity is subject to the taxes imposed by sections 3101 and 3111.

Chapter 22.—Railroad Retirement Tax Act
Subchapter C.—Tax on Employers

Section 3221.—Rate of Tax

Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in section 3221(c) of the Railroad Retirement Act (26 U.S.C. 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning January 1, 1990, shall be at the rate of 26 cents.

In accordance with directions in sections 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning January 1, 1990, 32.6 percent of the taxes collected under sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 67.4 percent of the taxes collected under such sections 3211(b) and 3221(c) plus 100 percent of the taxes collected under section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

By Authority of the Board.
Dated: December 20, 1989.

Beatrice Ezerski,
Secretary to the Board.

(Filed by the Office of the Federal Register on December 29, 1989, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1990, 55 F.R. 74)

Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C., section 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning April 1, 1990, shall be at the rate of 26 cents.

In accordance with directions in section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning April 1, 1990, 31.3 percent of the taxes collected under sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 68.7 percent of the taxes collected under such sections 3211(b) and 3221(c) plus 100 percent of the taxes collected under section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

Dated: March 14, 1990.
By Authority of the Board.

Beatrice Ezerski,
Secretary to the Board.

(Filed by the Office of the Federal Register on March 21, 1990, 8:45 a.m., and published in the issue of the Federal Register for March 22, 1990, 55 F.R. 10735)

Chapter 24.—Collection of Income Tax at Source on Wages
Subchapter A.—Withholding from Wages

Section 3402.—Income Tax Collected at Source

26 CFR 31.3402(b)-1: Percentage method withholding.

Requirements and conditions for submitting Forms W-4 on magnetic tape. See Rev. Proc. 90-9, page 460.

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26 CFR 31.3402(f)(5)-1: Form and contents of withholding exemption certificates.

Requirements and conditions for submitting Forms W-4 on magnetic tape. See Rev. Proc. 90-9, page 460.

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26 CFR 31.3402(h)(4)-1: Other methods.

Requirements and conditions for submitting Forms W-4 on magnetic tape. See Rev. Proc. 90-9, page 460.

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26 CFR 31.3402(p)-1: Voluntary withholding agreements.

Requirements and conditions for submitting Forms W-4 on magnetic tape. See Rev. Proc. 90-9, page 460.

Chapter 42.—Private Foundations and Certain Other Tax-exempt Organizations
Subchapter A.—Private Foundations

Section 4942.—Taxes on Failure to Distribute Income

26 CFR 53.4942(b)-1: Operating foundations.

Revised procedures are provided for issuing rulings and determination letters in response to applications for recognition of exemption from federal income tax. See Rev. Proc. 90-27, page 514.

Subtitle F.—Procedure and Administration
Chapter 61.—Information and Returns
Subchapter A.—Returns and Records
Part I.—Records, Statements, and Special Returns

Section 6001.—Notice or Regulations Requiring Records, Statements, and Special Returns

26 CFR 31.6001-5: Additional records in connection with collection of income tax at source of wages.

Requirements and conditions for submitting Forms W-4 on magnetic tape. See Rev. Proc. 90-9, page 460.

Part II.—Tax Returns or Statements
Subpart B.—Income Tax Returns

Section 6012.—Persons Required to Make Returns of Income

26 CFR 1.6012-1: Individuals required to make returns of income.

The Service is providing adjusted tax tables for individuals and trusts and estates for taxable years beginning in 1990 to reflect changes in the cost of living. See Rev. Proc. 90-7, page 432.

Section 6013.—Joint Returns of Income Tax by Husband and Wife

26 CFR 1.6013-1: Joint returns.

The Service is providing adjusted tax tables for individuals and trusts and estates for taxable years beginning in 1990 to reflect changes in the cost of living. See Rev. Proc. 90-7, page 432.

Part V.—Time for Filing Returns and Other Documents

Section 6072.—Time for Filing Income Tax Returns

26 CFR 1.6072-1: Time for filing returns of individuals, estates, and trusts.

Guidance is provided regarding the filing of income tax returns and the making of estimated income tax payments when April 15 falls on a Saturday or Sunday followed on Monday by Patriots' Day, a legal holiday in Massachusetts and Maine. See Rev. Rul. 90-5, page 189.

Subchapter B.—Miscellaneous Provisions

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 301.6103(j)(1)-1: Disclosures of return information to officers and employees of the Department of Commerce for certain statistical purposes and related activities.

T.D. 8296

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR PART 301

Disclosure of Return Information to the Bureau of the Census

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that amend the regulations on Procedure and Administration. The final regulations authorize the disclosure of three additional items of return information to the Bureau of the Census for use in certain statistical programs and delete the authority to disclose those items of return information that the Bureau no longer needs. These regulations provide guidance to Internal Revenue Service personnel responsible for disclosing the information.

EFFECTIVE DATE: These regulations are effective March 28, 1990.

SUPPLEMENTARY INFORMATION:

Background

This document adopts without change the proposed amendments to the regulations on Procedure and Administration (26 CFR Part 301) under section 6103(j)(1) of the Internal Revenue Code of 1986 that were published in 53 FR 50243 (December 14, 1988) [IA-42-88, 1989-1 C.B. 1019].

Before adopting the final regulations, the Internal Revenue Service solicited comments and requests for a public hearing on the proposed amendments. No comments or requests for a public hearing were received.

Under section 6103(j)(1), upon written request from the Secretary of Commerce, the Secretary of the Treasury or his delegate is to furnish such tax return information as may be prescribed by Treasury regulations to the Bureau of the Census for statutorily authorized statistical activities. Section 301.6103(j)(1)-1 of the regulations provides an itemized description of the return information authorized to be disclosed for this purpose.

Periodically, the disclosure regulations are amended to reflect the changing statistical needs of the Bureau of the Census for tax information, and these final regulations are an update of those regulations.

Explanation of Provisions

The request by the Secretary of Commerce for amendment of the regulations indicates that the Bureau of the Census needs the following three new data items from returns of individual taxpayers for use in its statutorily authorized postcensal population and per capita income estimates programs: (1) the type of tax return filed (i.e., Form 1040, Form 1040A, etc.); (2) whether the taxpayer itemized deductions for federal income tax purposes; and (3) whether the taxpayer received Social Security benefits. The Bureau needs this information to help it determine whether a taxpayer is over 65 years of age.

These regulations amend §301.6103(j)(1)-1 of the present regulations to add three items to the list of return information authorized to be disclosed and deletes two items of return information that the Bureau of the Census no longer needs.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

List of Subjects in 26 CFR Part 301

Administrative practice and procedure, Bankruptcy, Courts, Crime, Employment taxes, Estate taxes, Excise taxes, Gift, Income taxes, Investigations, Law enforcement, Penalties, Pensions, Statistics, Taxes, Disclosure of information, Filing requirements.

Accordingly, Title 26, Part 301 of the Code of Federal Regulations is amended as follows:

PART 301—[AMENDED]

Paragraph 1. The authority for Part 301 continues to read in part:

Authority: 26 U.S.C. 7805. ***

Section 301.6103(j)(1)-1 also issued under 26 U.S.C. 6103(j).

Par. 2. In 301.6103(j)(1)-1, paragraphs (b)(1)(i) through (xiv) are revised and paragraph (b)(1)(xv) is added to read as follows:

301.6103(j)(1)-1 Disclosures of return information to officers and employees of the Department of Commerce for certain statistical purposes and related activities.

* * * * *

(b) *Disclosure of return information to officers and employees of the Bureau of the Census.*

(1) ***

(i) Taxpayer identity information (as defined in section 6103(b)(6) of the Code), validity code with respect to the taxpayer identifying number (as described in section 6109), and taxpayer identifying number of spouse, if reported;

(ii) District office and service center codes;

(iii) Marital status;

(iv) Numbers and classifications of report exemptions;

(v) Adjusted gross income;

(vi) Wage and salary income;

(vii) Dividend income;

(viii) Interest income;

(ix) Gross rent and royalty income;

(x) Type of tax return filed;

(xi) Residence information from the revenue sharing question;

(xii) Code indicators for Form 1040; Schedules C, D, E, F, and SE;

(xiii) Julian date relative to filing;

(xiv) Whether deductions were itemized; and

(xv) Social Security benefits.

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Fred T. Goldberg. Jr.,
Commissioner of Internal Revenue.

Approved March 15, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 27, 1990, 8:45 a.m., and published in the issue of the Federal Register for March 28, 1990, 55 F.R. 11367)

Section 6114.—Treaty Based Return Positions

26 CFR 301.6114-1: Treaty based return positions.

T.D. 8292

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 301 and 602

Treaty-Based Return Positions

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final Income Tax Regulations relating to the requirement that any taxpayer who takes a position that a treaty of the United States overrules, or otherwise modifies, an internal revenue law of the United States shall disclose such position. These final regulations are necessary to provide guidance needed to implement sections 6114 and 6712 of the Internal Revenue Code of 1986 as added by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA).

DATES: These regulations are effective for taxable years of the taxpayer for which the due date for filing returns (without extensions) occurs after December 31, 1988. However, if the due date for filing the return (with extensions) occurs on or before April 13, 1990, the taxpayer may choose to apply the provisions of the temporary regulations sections 301.6114-1T and 301.6712-1T.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this final regulation has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3504(h)) under the control number 1545-1126. The estimated annual burden per respondent varies from 1/2 hour to 3 hours depending on individual circumstances, with an average estimate of one hour.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents may require greater or less time depending on their particular circumstances.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224, and to the Office of Management and Budget, Attention: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Background

On September 11, 1989, the FEDERAL REGISTER published proposed amendments (54 FR 37451) [T.D. 8262, 1989-2 C.B. 253] to the Income Tax Regulations 26 CFR Part 301) under sections 6114 and 6712 of the Internal Revenue Code. These amendments implement and provide guidance with respect to section 6114, which was added to the Code by section 1012(aa)(5)(A) of TAMRA, and section 6712, which was added to the Code by section 1012(aa)(5)(B) of TAMRA. Written comments responding to this notice were received. No public hearing was requested and none was held. After consideration of all comments regarding the proposed amendments, the amendments are adopted by this Treasury Decision with revisions in response to those comments. The significant comments and revisions are described below.

Explanation of Provisions

Example (2) of §301.6114-1(a)(3) has been removed as unnecessary.

Several comments were received suggesting that the exception in §301.6114-1(c)(1) to the waiver of the

reporting requirement concerning the reporting of fixed or determinable annual or periodical income subject to withholding under section 1441 or 1442 and received by a foreign person from a U.S. person when either person controls, within the meaning of section 6038 or 6038A, the other person would result in burdensome reporting duplicative of other reporting requirements. In response to these comments, the language of §301.6114–1(b)(4)(ii) has been modified to exclude from the disclosure requirement of section 6114 and §301.6114–1(a)(1) positions taken by a taxpayer that a treaty reduces the rate of tax on fixed or determinable annual or periodical income subject to withholding received by a controlled foreign corporation. In addition, this reporting is no longer required on payments between related parties (as defined) when the payment has been properly reported to the Service on Form 1042S. The language of §301.6114–1(b)(4)(ii) has been revised, effective for tax years beginning after July 10, 1989, to apply to shareholders of a domestic corporation (or a foreign corporation engaged in a trade or business in the United States) that is 25-percent foreign-owned within the meaning of section 6038A, to conform with the revision to section 6038A made by section 7403 of the Revenue Reconciliation Act of 1989 [Pub. L. 101–239, page 210, this Bulletin].

The Service expects to consider revising applicable information reporting forms (such as Forms 1042S, 5471 and 5472) to require disclosure of additional information, such as the provision(s) of any limitation of benefits article which the taxpayer relies upon to prevent the application of that article.

Although no change has been made to §301.6114–1(c)(1), the Service recognizes that this provision does not relate to fixed or determinable annual or periodical income attributable to a permanent establishment that is subject to tax on a net basis (see also §301.6114–1(b)(5)(i)).

The language of §301.6114–1(c)(2) should not be read to relax or modify any reporting requirement of any other provision of the Code or regulations. Thus, for example, any reporting requirement under section 7701(b) would not be affected by this provision.

In response to a comment, a new §301.6114–1(c)(4) has been added to waive reporting under section 6114 and §301.6114–1(a) with respect to income of an individual that is resourced (for purposes of applying the foreign tax credit limitation) under a treaty provision relating to elimination of double taxation. Examples of types of income that would be subject to this provision would be income subject to paragraph 3 or paragraph 6 of Article XXIV of the United States-Canada Income Tax Treaty. Sections 301.6114–1(c)(4) and (5) have been renumbered, and a cross reference in §301.6114–1(b)(6) has been added.

In response to comments, a new §301.6114–1(c)(7) has been added to waive reporting with respect to the excise tax imposed by section 4371 if reporting that would otherwise be required on a quarterly basis is made on an annual basis; or if a person, other than the taxpayer, who is liable under section 4374 for such excise tax on the same premium properly reports the information required by §301.6114–1(d)(4); or if a closing agreement has been entered into with the Service by the foreign insurance company that is the beneficial recipient of the premium subject to the excise tax.

Language has been added to §301.6114–1(c) to indicate that reporting under section 6114 is not required with respect to income items the tax treatment of which is mandated by the terms of a closing agreement with the Service.

Language has been added to §301.6114–1(d)(4) to indicate that, for purposes of paragraph (d)(4)(i), a taxpayer not having a permanent establishment or fixed base in the United States (and properly disclosing that position) need not report its payment of actual or deemed dividends or interest exempt from tax by reason of a treaty (or any liability for tax under section 884(a)).

In addition, §301.6114–1(d)(4)(i) has been clarified to indicate that it is the nature and amount (or a reasonable estimate thereof) of each separate gross payment or separate gross income item for which the treaty benefit is claimed that is to be reported.

Comments were received stating that certain foreign corporations engaged in trade or business in the United States are, pursuant to specific treaty provisions, subject to U.S. tax solely on income from sources inside the United States (and not on otherwise effectively connected foreign source income). To provide a separate disclosure statement for each item of excluded foreign source income would be unduly burdensome. Language has been added to §301.6114–1(d)(4) to permit the treatment of these payments or income items of the same type as a single payment or income item. This provision is relevant only to claims under certain older treaties that restrict the right of the United States to tax effectively connected foreign source income.

Comments were also received stating that sales in the United States by an agent on behalf of a foreign corporation not having a permanent establishment in the United States are often exempt from U.S. tax under an article of a treaty relating to business profits. To provide a separate disclosure for each such sale would be unduly burdensome. Language has been added to §301.6114–1(d) to permit the treatment of income from separate sales or services, whether or not made by an agent, as a single payment or income item.

In addition, in response to comments, it should be observed that an exchange of notes (such as an exchange confirming reciprocal exemptions from certain taxes on transportation income), by itself and not under a treaty, is not considered to be a treaty and, thus, would not be considered to overrule or otherwise modify a provision of the Code so that reporting would be required under section 6114. However, if an exchange of notes operates in conjunction with a treaty to overrule or otherwise modify a provision of the Code, reporting would be required if a position is taken under that exchange of notes.

One commenter has suggested that disclosure under section 6661 should be viewed as adequate disclosure for purposes of section 6114 as well. Disclosure for section 6661 is not disclosure for purposes of section 6114 and §301.6114–1(a) unless such disclosure is clearly labeled as also

applying to section 6114 and contains all of the information required by, and otherwise meets the requirements of, §301.6114-1(d). In addition, section 6114 and §301.6114-1 do not change or otherwise modify the filing requirements of section 6012.

The language of §301.6712-1 has been expanded to state more clearly that the penalties imposed by section 6712 are imposed on each separate payment or income item and that, for purposes of section 6712 and §301.6712-1, aggregation of separate payments or income items of the same type or received from the same ultimate payor is not permitted. However, for purposes of determining the number of separate penalties to be imposed under §301.6712-1(a), the District Director will have discretion to aggregate separate payments or income items, in whole or in part, in accordance with the rules for the aggregation of such payments or income items for purposes of reporting, as described in §301.6114-1(d).

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 301 and 602 are amended as follows:

Part 301—REGULATIONS ON PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority for Part 301 is amended by removing the citation for section 301.6114-1T and adding the following citation for section 301.6114-1:

Authority: 26 U.S.C. 7805. *** Section 301.6114-1 also issued under 26 U.S.C. 6114.***

Par. 2. Sections 301.6114-1T and 301.6712-1T are removed.

Par. 3. New §§301.6114-1 and 301.6712-1 are added in the appropriate places to read as follows:

§301.6114-1 Treaty-based return positions.[1]

(a) *Reporting requirement*—(1) *General rule.* (i) Except as provided in paragraph (c) of this section, if a taxpayer takes a return position that any treaty of the United States (including, but not limited to, an income tax treaty, estate and gift tax treaty, or friendship, commerce and navigation treaty) overrules or modifies any provision of the Internal Revenue Code and thereby effects (or potentially effects) a reduction of any tax incurred at any time, the taxpayer shall disclose such return position on a statement (in the form required in paragraph (d) of this section) attached to such return.

(ii) If a return of tax would not otherwise be required to be filed, a return must, nevertheless, be filed for purposes of making the disclosure required by this section. For this purpose, such return need include only the taxpayer's name, address, Taxpayer Identification Number (if any), and be signed under the penalties of perjury (as well as the subject disclosure). Also, the taxpayer's taxable year shall be deemed to be the calendar year (unless the taxpayer has previously established, or timely chooses for this purpose to establish, a different taxable year).

(2) *Application.* (i) A taxpayer is considered to adopt a "return position" when the taxpayer determines its tax liability with respect to a particular item of income, deduction or credit. A taxpayer may be considered to adopt a return position whether or not a return is actually filed. To determine whether a return position is a "treaty-based return position" so that reporting is required under this paragraph (a), the taxpayer must compare:

(A) The tax liability (including credits, carrybacks, carryovers, and other tax consequences or attributes for the current year as well as for any other affected tax years) to be reported on a return of the taxpayer, and

(B) The tax liability (including such credits, carrybacks, carryovers, and other tax consequences or attributes) that would be reported if the relevant treaty provision did not exist. If there is a difference (or potential difference) in these two amounts, the position taken on a return is a treaty-based return position that must be reported.

(ii) In the event a taxpayer's return position is based on a conclusion that a treaty provision is consistent with a Code provision, but the effect of the treaty provision is to alter the scope of the Code provision from the scope that it would have in the absence of the treaty, then the return position is a treaty-based return position that must be reported.

(iii) A return position is a treaty-based return position unless the taxpayer's conclusion that no reporting is required under paragraphs (a)(2)(i) and (ii) of this section has a substantial probability of successful defense if challenged.

(3) *Examples.* The application of section 6114 and paragraph (a)(2) of this section may be illustrated by the following examples:

Example (1). X, a Country A corporation, claims the benefit of a provision of the income tax treaty between the United States and Country A that modifies a provision of the Code. This position does not result in a change of X's U.S. tax liability for the current tax year but does give rise to or increases, a net operating loss which may be carried back (or forward) such that X's tax liability in the carryback (or forward) year may be affected by the position taken by X in the current year. X must disclose this treaty-based return position with its tax return for the current tax year.

Example (2). Z, a domestic corporation, is engaged in a trade or business in Country B. Country B imposes a tax on the income from certain of Z's petroleum activities at a rate significantly greater than the rate applicable to income from other activities. Z claims a foreign tax credit for this tax on its tax return. The tax imposed on Z is specifically listed as a creditable tax in the income tax treaty between the United States and Country B; however, there is

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[1]The language is corrected per 55 F.R. 10236 and any taxpayer required to file a tax return on March 15, 1990, who did not obtain an extension of time in which to file that return—

(1) For whom reporting is required under §301.6114-1(b)(4)(ii) as so corrected, and

(2) For whom reporting was not required under that section as published in the Federal Register on Wednesday, March 14, 1990,

is hereby allowed until June 12, 1990, to so report under that section as corrected.

no specific authority that such tax would otherwise be a creditable tax for U.S. purposes under sections 901 or 903 of the Code. Therefore, in the absence of the treaty, the creditability of this petroleum tax would lack a substantial probability of successful defense if challenged, and Z must disclose this treaty-based return position (see also paragraph (b)(7) of this section).

(b) *Reporting specifically required.* Reporting is required under this section except as expressly waived under paragraph (c) of this section. The following list is not a list of all positions for which reporting is required under this section but is a list of particular positions for which reporting is specifically required. These positions are as follows:

(1) That a nondiscrimination provision of a treaty precludes the application of any otherwise applicable Code provision, other than with respect to the making of or the effect of an election under section 897(i);

(2) That a treaty reduces or modifies the taxation of gain or loss from the disposition of a United States real property interest;

(3) That a treaty exempts a foreign corporation from (or reduces the amount of tax with respect to) the branch profits tax (section 884(a)) or the tax on excess interest (section 884(f)(1)(B));

(4) That, notwithstanding paragraph (c)(1) of this section,

(i) A treaty exempts from tax, or reduces the rate of tax on, interest or dividends paid by a foreign corporation that are from sources within the United States by reason of section 861(a)(2)(B) or section 884(f)(1)(A); or

(ii) A treaty reduces the rate of tax on fixed or determinable annual or periodical income subject to withholding under section 1441 or 1442 that a foreign person receives from a U.S. person, but only if—

(A) The payment is not properly reported to the Service on a Form 1042S; and

(B) The foreign person is any of the following:

(*1*) A controlled foreign corporation (as defined in section 957);

(*2*) A foreign corporation that is controlled within the meaning of section 6038 by a U.S. person; or

(*3*) In the case of tax years beginning on or before July 10, 1989, the shareholder of a domestic corporation (or a foreign corporation engaged in a trade or business in the United States) that is controlled within the meaning of section 6038A by a foreign person, or, in the case of tax years beginning after July 10, 1989, is 25-percent foreign-owned within the meaning of section 6038A; or

(5) That, under a treaty—

(i) Income that is effectively connected with a U.S. trade or business of a foreign corporation or a nonresident alien is not attributable to a permanent establishment or a fixed base of operations in the United States and, thus, is not subject to taxation on a net basis, or that

(ii) Expenses are allowable in determining net business income so attributable, notwithstanding an inconsistent provision of the Code;

(6) Except as provided in paragraph (c)(4) of this section, that a treaty alters the source of any item of income or deduction; or

(7) That a treaty grants a credit for a specific foreign tax for which a foreign tax credit would not be allowed by the Code.

(c) *Reporting requirement waived.* Pursuant to the authority contained in section 6114(b), reporting is waived under this section with respect to any of the following return positions taken by the taxpayer:

(1) Except as provided in paragraph (b)(4) of this section, that a treaty has reduced the rate of withholding tax otherwise applicable to a particular type of fixed or determinable annual or periodical income subject to withholding under section 1441 or 1442, such as dividends, interest, rents, or royalties;

(2) That residency of an individual is determined under a treaty and apart from the Code;

(3) That a treaty reduces or modifies the taxation of income derived from dependent personal services, pensions, annuities, social security and other public pensions, or income derived by artists, athletes, students, trainees or teachers;

(4) That income of an individual is resourced (for purposes of applying the foreign tax credit limitation) under a treaty provision relating to elimination of double taxation;

(5) That a nondiscrimination provision of a treaty allows the making of an election under section 897(i);

(6) That a Social Security Totalization Agreement or a Diplomatic or Consular Agreement reduces or modifies the taxation of income derived by the taxpayer; or

(7) That a treaty exempts the taxpayer from the excise tax imposed by section 4371, but only if:

(i) Reporting under this section that otherwise would be required to be made on a quarterly basis with a Form 720 is made on an annual basis on the Form 720 for the last quarter of the taxpayer's taxable year,

(ii) A person, other than the taxpayer, who is liable under section 4374 for such excise tax on the same premium properly reports the information required by paragraph (d)(4) of this section, or

(iii) A closing agreement relating to entitlement to the exemption from the excise tax has been entered into with the Service by the foreign insurance company that is the beneficial recipient of the premium that is subject to the excise tax. Reporting with respect to payments or income items the treatment of which is mandated by the terms of a closing agreement with the Service, and that would otherwise be subject to the reporting requirements of this section, is also waived. In addition, if a partnership, trust, or estate that has the taxpayer as a partner or beneficiary discloses on its information return a position for which reporting is otherwise required by the taxpayer, the taxpayer (partner or beneficiary) is then excused from disclosing that position on a return. Also, this section does not apply to a withholding agent with respect to the performance of its withholding functions.

(d) *Information to be reported.* If reporting is required under this section, the following information must be furnished in accordance with paragraph (a) of this section as an attachment to the return and set forth with the indicated heading and with paragraphs labeled to correspond with the numbers set forth below:

TREATY-BASED RETURN POSITION DISCLOSURE UNDER SECTION 6114

(1) Taxpayer's name, T.I.N. (if any), and address both in the coun-

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try of residence and in the United States;

(2) Name, T.I.N. (if available to the taxpayer), and address in the United States of the payor of the income (if fixed, determinable, annual, or periodical);

(3) A statement whether the taxpayer (if an individual) is a U.S. citizen or resident or (if a corporation) is incorporated in the United States;

(4) A separate statement of facts relied upon to support each separate position taken, including for each position:

(i) The nature and amount (or a reasonable estimate thereof) of gross receipts, each separate gross payment, each separate gross income item, or other item (as applicable) for which the treaty benefit is claimed,

(ii) An explanation of the position taken with a brief summary of the facts on which it is based,

(iii) The specific treaty provision relied upon,

(iv) The Code provision(s) overruled or modified, and

(v) The provision(s) of the limitation on benefits article (if any) in the treaty which the taxpayer relies upon to prevent application of that article.

For purposes of paragraph (d)(4)(i) of this section, if a taxpayer takes a position that it does not have a permanent establishment or fixed base in the United States and properly discloses that position, it need not separately report its payment of actual or deemed dividends or interest exempt from tax by reason of a treaty (or any liability for tax imposed by reason of section 884). Also, for purposes of paragraph (d)(4)(i) of this section, a taxpayer may treat payments or income items of the same type (*e.g.*, interest items) received from the same ultimate payor (*e.g.*, the obligor on a note) as a single separate payment or income item. For purposes of paragraph (d)(4), if a taxpayer takes the return position that, under a treaty, income that is effectively connected with a U.S. trade or business is not subject to U.S. taxation because it is derived from sources outside of the United States, the taxpayer may treat payments or income items of the same type (*e.g.*, interest items) as a single separate payment or income item. In addition, income from separate sales or services, whether or not made by an agent (independent or dependent), to different U.S. customers on behalf of a foreign corporation not having a permanent establishment in the United States may be treated as a single payment or income item.

(e) *Effective date.* This section is effective for taxable years of the taxpayer for which the due date for filing returns (without extensions) occurs after December 31, 1988. However, if—

(1) A taxpayer has filed a return for such a taxable year, without complying with the reporting requirement of this section, before November 13, 1989, or

(2) A taxpayer is not otherwise than by paragraph (a) of this section required to file a return for a taxable year before November 13, 1989,

such taxpayer must file (apart from any earlier filed return) the statement required by paragraph (d) of this section before June 12, 1990, by mailing the required statement to the Internal Revenue Service, P.O. Box 21086, Philadelphia, PA 19114. Any such statement filed apart from a return must be dated, signed and sworn to by the taxpayer under the penalties of perjury. In addition, with respect to any return due (without extensions) on or before March 10, 1990, the reporting required by paragraph (a) of this section must be made no later than June 12, 1990. If a taxpayer files or has filed a return on or before November 13, 1989, that provides substantially the same information required by paragraph (d) of this section, no additional submission will be required.

(f) *Cross reference.* For the provisions concerning penalties for failure to disclose a treaty-based return position, see section 6712 and §301.6712-1.

§301.6712-1 Failure to disclose treaty-based return positions.

(a) *Penalty imposed.* A taxpayer who fails in a material way to disclose one or more positions taken for a taxable year, as required by section 6114 and the regulations thereunder, is subject to a separate penalty for each failure to disclose a position taken with respect to each separate payment or separate income item in the amount of—

(1) For a corporation taxable as such under the Code, $10,000; or

(2) For all other taxpayers, $1,000.

The penalty imposed by this section may be imposed more than once for a single taxable year if a taxpayer has failed to disclose one or more positions taken with respect to more than one separate payment or separate income item and may be imposed in addition to any other penalty imposed by law. For this purpose, separate payments or income items of the same type (*e.g.*, interest payments) received from the same ultimate payor (*e.g.*, the obligor on the note) will be treated as separate payments or income items (and not aggregated). However, for purposes of determining the number of separate penalties to be imposed under this section, the District Director shall have the discretion to aggregate separate payments or income items, in whole or in part, in accordance with the rules for aggregation of such items for purposes of reporting, as described in §301.6114-1(d).

(b) *Penalty waived.* Pursuant to the authority contained in section 6712(b) of the Code, the penalty imposed by paragraph (a) of this section may be waived, in whole or in part, if it is established to the satisfaction of the Assistant Commissioner (International), the district director or the director of the Internal Revenue Service Center that the taxpayer's failure to disclose the required information was not due to willful neglect. An affirmative showing of lack of willful neglect must be made in the form of a written statement that sets forth all the facts alleged to show lack of willful neglect and contains a declaration by such person that the statement is made under the penalties of perjury.

(c) *Manner of payment.* The penalty set forth in paragraph (a) of this section shall be paid in the same manner as tax upon the issuance of a notice and demand thereof.

(d) *Effective date.* This section is effective for taxable years of the taxpayer for which the due date for filing returns (without extension) occurs after December 31, 1988.

Part 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. Section 602.101(c) is amended by removing from the table "§301.6114-1T. . .1545-1126 and §301.6712-1T. . .1545-1126" and by inserting in the respective appropriate places in the table:

"§301.6114-1. . .1545-1126."
"§301.6712-1. . .1545-1126."

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved February 28, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 13, 1990, 8:45 a.m., and published in the issue of the Federal Register for March 14, 1990, 55 F.R. 9438 and corrected by 55 F.R. 10236)

Chapter 63.—Assessment

Subchapter B.—Deficiency Procedures in the Case of Income, Estate, Gift, and Certain Excise Taxes

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Section 6212.—Notice of Deficiency

26 CFR 301.6212-1: Notice of deficiency.

The address on the most recently filed and properly processed return is the taxpayer's "last known address," unless the Service has been given clear and concise written notification of a change of address. The methods taxpayers are to use to inform the Service of a change of address are described. See Rev. Proc. 90-18, page 491.

Chapter 64.—Collection

Subchapter E.—Collection of State Individual Income Taxes

Section 6361.—General Rules

Requirements and conditions for submitting Forms W-4 on magnetic tape. See Rev. Proc. 90-9, page 460.

Chapter 65.—Abatements, Credits, and Refunds

Subchapter A.—Procedure in General

Section 6404.—Abatements

26 CFR 301.6404-0: Table of contents.

T.D. 8299

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 301 and 602

Abatement of Penalty or Addition to Tax Attributable to Erroneous Advice

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the abatement of a portion of any penalty or addition to tax attributable to erroneous written advice furnished to a taxpayer by an officer or employee of the Internal Revenue Service, acting in such officer's or employee's official capacity. Changes to the applicable law were made by the Omnibus Taxpayer Bill of Rights provisions of the Technical and Miscellaneous Revenue Act of 1988. The regulations affect all taxpayers, and provide guidance regarding the definition of "advice" and the procedures that must be followed to obtain an abatement.

EFFECTIVE DATE: The regulations are effective with respect to advice requested on or after January 1, 1989.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information requirements contained in this final regulation have been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545-0024. The time estimates for the reporting and recordkeeping requirements contained in this regulation are included in the burden of Form 843.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents/recordkeepers may require greater or less time, depending on their particular circumstances.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the Internal Revenue Service, Attn: IRS Reports Clearance Officer T:FP, Washington, D.C. 20224, and to the Office of Management and Budget (1545-0024), Paperwork Reduction Project, Washington, D.C. 20503.

Background

This document contains final regulations under section 6404(f) of the Internal Revenue Code of 1986 (Code). Section 6404(f) was added by section 6229 of the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. 100-647, 102 Stat. 3342). On May 16, 1989, the FEDERAL REGISTER published a notice of proposed rulemaking (54 FR 21073) [IA-24-89, 1989-1 C.B. 1021] proposing amendments to the Income Tax Regulations (26 CFR Part 301) under section 6404 by cross-reference to temporary regulations published the same day in the Federal Register (T.D. 8254; 54 FR 21055) [1989-1 C.B. 304]. The Internal Revenue Service did not receive any comments on the proposed regulations. No public hearing was requested or held. For this reason, the final regulations adopt the temporary regulations without any substantive changes.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 301 and 602 are amended as follows:

Paragraph 1. The authority for Part 301 is amended by removing the citation for §301.6404-T and adding the following citation:

Authority: 26 U.S.C. 7805 *** Section 301.6404-3 is also issued under

26 U.S.C. 6404(f)(3).

Par. 2. §301.6404-0T is redesignated as §301.6404-0 and is revised to read as follows:

§301.6404-0 Table of contents.

This section lists the paragraphs contained in sections 301.6404-1—301.6404-3.

§301.6404-1 Abatements.

§301.6404-2T Definition of ministerial act (temporary).

(a) In general.

(b) Ministerial act.

(1) Definition.

(2) Examples.

(c) Effective date.

§301.6404-3 Abatement of penalty or addition to tax attributable to erroneous written advice of the Internal Revenue Service.

(a) General rule.

(b) Requirements.

(1) In general.

(2) Advice was reasonably relied upon.

(i) In general.

(ii) Advice relating to a tax return.

(iii) Amended returns.

(iv) Advice not related to a tax return.

(v) Period of reliance.

(3) Advice was in response to written request.

(4) Taxpayer's information must be adequate and accurate.

(c) Definitions.

(1) Advice.

(2) Penalty and addition to tax.

(d) Procedures for abatement.

(e) Period for requesting abatement.

(f) Examples.

(g) Effective date.

Par. 3. Section 301.6404-3T is redesignated as §301.6404-3. The title of that section is revised to read as follows:

§301.6404-3 Abatement of penalty or addition to tax attributable to erroneous written advice of the Internal Revenue Service.

* * * * *

Par. 4. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805

Par. 5. Section 602.101(c) is amended by inserting the following item in the appropriate place in the table:

§301.6404-3	1545-0024

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved March 14, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on April 16, 1990, 8:45 a.m., and published in the issue of the Federal Register for April 17, 1990, 55 F.R. 14244)

Chapter 67.—Interest

Subchapter C.—Determination of Interest Rate; Compounding of Interest

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Section 6621.—Determination of Rate of Interest

26 CFR 301.6621-1: Interest rate.

Interest rates: underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning April 1, 1990, will remain at 10 percent for overpayments and 11 percent for underpayments.

Rev. Rul. 90-19[1]

Section 6621 of the Internal Revenue Code establishes differential rates for allowance of interest on tax overpayments and assessment of interest on tax underpayments. Under section 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 2 percentage points. Under section 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(b)(1) of the Code provides that the Secretary shall determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) of the Code provides that the federal short-term rate determined under section 6621(b)(1) for any month shall apply during the first calendar quarter beginning after such month.

Section 6621(b)(2)(B) of the Code provides that in determining the addition to tax under section 6654 for failure to pay estimated tax for any taxable year, the federal short-term rate which applies during the third month following such taxable year shall also apply during the first 15 days of the fourth month following such taxable year.

Section 6621(b)(3) of the Code provides that the federal short-term rate for any month shall be the federal short-term rate determined during such month by the Secretary in accordance with section 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate shall be increased to the next highest full percent).

Notice 88-59, 1988-1 C.B. 546, announced that in determining the quarterly interest rates to be used for overpayments and underpayments of tax under section 6621 of the Code, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with section 6621 which, pursuant to section 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of January 1990 is 8 percent. Accordingly, an overpayment rate of 10 percent and an underpayment rate of 11 percent are established for the calendar quarter beginning April 1, 1990. These rates apply to amounts bearing interest during that calendar quarter. In addition, pursuant to section 6621(b)-(2)(B) of the Code, the rate applicable to underpayments for the calendar quarter beginning January 1, 1990, continues to be applicable to individual estimated tax underpayments from April 1, 1990, through April 15, 1990. Because the underpayment rate for the calendar quarter beginning January 1, 1990, is also 11 percent, the rate applicable to individual estimated tax underpayments is 11 percent from April 1, 1990, to June 30, 1990.

Interest factors for daily compound interest for annual rates of 10 percent and 11 percent were published in Tables 16 and 17 of Rev. Proc. 83-7, 1983-1 C.B. 583, 599, 600.

Annual interest rates to be compounded daily pursuant to section 6622 of the Code that apply for prior periods are set forth in the accompanying tables.

[1]Also released as News Release IR-90-21, dated February 7, 1990.

TABLE OF INTEREST RATES
PERIODS BEFORE JUL. 1, 1975—DEC. 31, 1986
OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	Rate	DAILY RATE TABLE IN 1983-1 C.B.
Before Jul. 1, 1975	6%	Table 2, pg. 586
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 588
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 587
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 586
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 588
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 588
Jan. 1, 1983—Jun. 30, 1983	16%	Table 22, pg. 605
Jul. 1, 1983—Dec. 31, 1983	11%	Table 17, pg. 600
Jan. 1, 1984—Jun. 30, 1984	11%	Table 41, pg. 625
Jul. 1, 1984—Dec. 31, 1984	11%	Table 41, pg. 625
Jan. 1, 1985—Jun. 30, 1985	13%	Table 19, pg. 602
Jul. 1, 1985—Dec. 31, 1985	11%	Table 17, pg. 600
Jan. 1, 1986—Jun. 30, 1986	10%	Table 16, pg. 599
Jul. 1, 1986—Dec. 31, 1986	9%	Table 15, pg. 598

TABLE OF INTEREST RATES
FROM JAN. 1, 1987—PRESENT

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	TABLE	PG.	RATE	TABLE	PG.
Jan. 1, 1987—Mar. 31, 1987	8%	14	597	9%	15	598
Apr. 1, 1987—Jun. 30, 1987	8%	14	597	9%	15	598
Jul. 1, 1987—Sep. 30, 1987	8%	14	597	9%	15	598
Oct. 1, 1987—Dec. 31, 1987	9%	15	598	10%	16	599
Jan. 1, 1988—Mar. 31, 1988	10%	40	624	11%	41	625
Apr. 1, 1988—Jun. 30, 1988	9%	39	623	10%	40	624
Jul. 1, 1988—Sep. 30, 1988	9%	39	623	10%	40	624
Oct. 1, 1988—Dec. 31, 1988	10%	40	624	11%	41	625
Jan. 1, 1989—Mar. 31, 1989	10%	16	599	11%	17	600
Apr. 1, 1989—Jun. 30, 1989	11%	17	600	12%	18	601
Jul. 1, 1989—Sep. 30, 1989	11%	17	600	12%	18	601
Oct. 1, 1989—Dec. 31, 1989	10%	16	599	11%	17	600
Jan. 1, 1990—Mar. 31, 1990	10%	16	599	11%	17	600
Apr. 1, 1990—Jun. 30, 1990	10%	16	599	11%	17	600

26 CFR 301.6621-1: Interest rate.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning July 1, 1990, will remain at 10 percent for overpayments and 11 percent for underpayments.

Rev. Rul. 90-47

Section 6621 of the Internal Revenue Code establishes differential rates for allowance of interest on tax overpayments and assessment of interest on tax underpayments. Under section 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 2 percentage points. Under section 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(b)(1) of the Code provides that the Secretary shall determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) of the Code provides that the federal short-term rate determined under section 6621(b)(1) for any month shall apply during the first calendar quarter beginning after such month.

Section 6621(b)(3) of the Code provides that the federal short-term rate for any month shall be the federal short-term rate determined during such month by the Secretary in accordance with section 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate shall be increased to the next highest full percent).

Notice 88-59, 1988-1 C.B. 546, announced that in determining the quarterly interest rates to be used for overpayments and underpayments of tax under section 6621 of the Code, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with section 6621 which, pursuant to section 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of April 1990 is 8 percent. Accordingly, an overpayment rate of 10 percent and an underpayment rate of 11 percent are established for the calendar quarter beginning July 1, 1990.

Interest factors for daily compound interest for annual rates of 10 percent and 11 percent were published in Tables 16 and 17 of Rev. Proc. 83-7, 1983-1 C.B. 583, 599, 600.

Annual interest rates to be compounded daily pursuant to section 6622 of the Code that apply for prior periods are set forth in the accompanying tables.

TABLE OF INTEREST RATES
PERIODS BEFORE JUL. 1, 1975—DEC. 31, 1986
OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	DAILY RATE TABLE IN 1983-1 C.B.
Before Jul. 1, 1975	6%	Table 2, pg. 586
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 588
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 587
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 586
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 588
Feb 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 588
Jan 1, 1983—Jun. 30, 1983	16%	Table 22, pg. 605
Jul. 1, 1983—Dec. 31, 1983	11%	Table 17, pg. 600
Jan. 1, 1984—Jun. 30, 1984	11%	Table 41, pg. 625
Jul. 1, 1984—Dec. 31, 1984	11%	Table 41, pg. 625
Jan. 1, 1985—Jun. 30, 1985	13%	Table 19, pg. 602
Jul. 1, 1985—Dec. 31, 1985	11%	Table 17, pg. 600
Jan. 1, 1986—Jun. 30, 1986	10%	Table 16, pg. 599
Jul. 1, 1986—Dec. 31, 1986	9%	Table 15, pg. 598

TABLE OF INTEREST RATES
FROM JAN. 1, 1987—PRESENT

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	TABLE	PG.	RATE	TABLE	PG.
Jan. 1, 1987—Mar. 31, 1987	8%	14	597	9%	15	598
Apr. 1, 1987—Jun. 30, 1987	8%	14	597	9%	15	598
Jul. 1, 1987—Sep. 30, 1987	8%	14	597	9%	15	598
Oct. 1, 1987—Dec. 31, 1987	9%	15	598	10%	16	599
Jan. 1, 1988—Mar. 31, 1988	10%	40	624	11%	41	625
Apr. 1, 1988—Jun. 30, 1988	9%	39	623	10%	40	624
Jul. 1, 1988—Sep. 30, 1988	9%	39	623	10%	40	624
Oct. 1, 1988—Dec. 31, 1988	10%	40	624	11%	41	625
Jan. 1, 1989—Mar. 31, 1989	10%	16	599	11%	17	600
Apr. 1, 1989—Jun. 30, 1989	11%	17	600	12%	18	601
Jul. 1, 1989—Sep. 30, 1989	11%	17	600	12%	18	601
Oct. 1, 1989—Dec. 31, 1989	10%	16	599	11%	17	600
Jan. 1, 1990—Mar. 31, 1990	10%	16	599	11%	17	600
Apr. 1, 1990—Jun. 30, 1990	10%	16	599	11%	17	600
Jul. 1, 1990—Sep. 30, 1990	10%	16	599	11%	17	600

Chapter 68.—Additions to the Tax, Additional Amounts, and Assessable Penalties

Subchapter A.—Additions to the Tax and Additional Amounts

Part I.—General Rule

Section 6654.—Failure by Individuals to Pay Estimated Income Tax

26 CFR 1.6654-1: Addition to the tax in the case of an individual.

Guidance is provided regarding the filing of income tax returns and the making of estimated income tax payments when April 15 falls on a Saturday or Sunday followed on Monday by Patriots' Day, a legal holiday in Massachusetts and Maine. See Rev. Rul. 90-5, this page.

Part II.—Accuracy-Related and Fraud Penalties

Section 6662.—Imposition of Accuracy-Related Penalty

Guidance is provided concerning when information shown on a return in accordance with the applicable forms and instructions will be adequate disclosure for purposes of reducing an understatement of income tax under section 6662(d) of the Code, as enacted by section 7721 of the Revenue Reconciliation Act of 1989 and, under limited circumstances, former section 6661. See Rev. Proc. 90-16, page 477.

Chapter 76.—Judicial Proceedings

Subchapter B.—Proceedings by Taxpayers and Third Parties

Section 7428.—Declaratory Judgments Relating to Status and Classification of Organizations Under Section 501(c)(3), Etc.

Revised procedures are provided for issuing rulings and determination letters in response to applications for recognition of exemption from federal income tax. See Rev. Proc. 90-27, page 514.

Chapter 77.—Miscellaneous Provisions

Section 7503.—Time for Performance of Acts Where Last Day Falls on Saturday, Sunday, or Legal Holiday

26 CFR 301.7503-1: Time for performance of acts where last day falls on Saturday, Sunday, or legal holiday.
(Also Sections 6072, 6654; 1.6072-1, 1.6654-1.)

Legal holiday filing requirements. Guidance is provided regarding the filing of income tax returns and the making of estimated income tax payments when April 15 falls on a Saturday or Sunday followed on Monday by Patriots' Day, a legal holiday in Massachusetts and Maine.

Rev. Rul. 90-5

ISSUE

In the situations described below, by what date must the specified act be performed if the due date for performing the act falls on a Saturday or Sunday that is followed on Monday by Patriots' Day, a legal holiday in Massachusetts and Maine?

FACTS

In each of these situations, April 15, the due date for performing the act, falls on either a Saturday or a Sunday. The following Monday is Patriots' Day, a legal holiday in Massachusetts and Maine but not in any other state.

Situation 1. *A*, an individual who is a resident of Connecticut, files *A*'s federal income tax return on a calendar year basis. Individuals who are residents of Connecticut are required to file their returns at the Andover, Massachusetts, Internal Revenue Service Center.

Situation 2. *B*, an individual who is a resident of Massachusetts, files *B*'s federal income tax return on a calendar year basis. Individuals who are residents of Massachusetts are required to file their returns at the Andover, Massachusetts, Internal Revenue Service Center. *B* also makes installment payments of estimated income tax for the calendar year. Individuals who are residents of Massachusetts are required to send their estimated income tax payments to a depository in Pittsburgh, Pennsylvania.

LAW AND ANALYSIS

Section 6072(a) of the Internal Revenue Code provides that individual income tax returns made on the basis of the calendar year shall be filed on or before the 15th day of April following the close of the calendar year.

Section 6654(c) provides that the due date for the first required installment payment of estimated income tax payment is April 15.

Section 7503 of the Code provides that when the last day for performing any act falls on a Saturday, Sunday, or legal holiday, performance of the act is considered timely if it is performed on the next day that is not a Saturday, Sunday, or legal holiday. In general, the term "legal holiday" is limited to federal legal holidays and those in the District of Columbia. However, section 7503 provides that, in the case of any return required to be filed at any office of the Secretary, or at any other office of the United States or any agency thereof, located outside the District of Columbia but within an Internal Revenue Service district, the term "legal holiday" includes a statewide legal holiday in the state where the office is located.

The third Monday in April is a statewide legal holiday, Patriots' Day, in Massachusetts and Maine. Mass. Ann. Laws. ch. 4, §7(18) (Law. Co-op. 1988); Me. Rev. Stat. Ann. tit. 4, §1051 (1988). When April 15 falls on a Saturday or Sunday, the following Monday is the third Monday in April.

The purpose of section 7503 of the Code is to extend the time for performing any act required by the internal revenue laws when the last day for performing the act would be a Saturday, Sunday, or legal holiday. Thus, when April 15 falls on a Saturday or Sunday, a taxpayer ordinarily would have to perform the specified act on or before the following Monday to be timely. However, in Massachusetts, where the Andover Service Center is located, that Monday is a statewide legal holiday. Accordingly, because *A* in *Situation 1* and *B* in *Situation 2* are required to file their federal income tax returns in Massachusetts, where the following Monday is a statewide legal holiday, *A* and *B* have until the third Tuesday in April, the next day after April 15 that is not a Saturday, Sunday, or legal holiday, to make a timely filing. The fact that *A* is not a resident of Massachusetts is of no consequence.

B in *Situation 2* is required to make installment payments of estimated income tax to a depository in Pittsburgh, Pennsylvania, a state in which the third Monday in April is not a statewide legal holiday. Accordingly, *B* in *Situation 2* must make the installment payment of estimated tax on or before the third Monday in April for the act to be timely. The fact that *B* is a resident of Massachusetts, a state in which the third Monday in April is a statewide legal holiday, is of no consequence.

HOLDINGS

A in *Situation 1* and *B* in *Situation 2* must file their federal income tax returns on or before the Tuesday immediately following Patriots' Day.

B in *Situation 2* must make the estimated income tax payment on or before Monday, Patriots' Day.

When April 15, the due date for filing federal individual income tax returns, falls on a Monday, that date is also Patriots' Day in Massachusetts and Maine. The holdings stated above are equally applicable when April 15 is Patriots' Day.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1990. See Rev. Rul. 90-1, page 155.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1990. See Rev. Rul. 90-12, page 156.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1990. See Rev. Rul. 90-22, page 158.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 1990. See Rev. Rul. 90-28, page 159.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1990. See Rev. Rul. 90-41, page 161.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 1990. See Rev. Rul. 90-48, page 162.

Chapter 78.—Discovery of Liability and Enforcement of Title

Subchapter A.—Examination and Inspection

Section 7605.—Time and Place of Examination

26 CFR 301.7605-1T: Time and place of examination (temporary).

T.D. 8297

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Time and Place of Examination

AGENCY: Internal Revenue Service, Treasury

ACTION: Temporary regulations

SUMMARY: This document contains temporary regulations that set forth the policy of the Internal Revenue Service concerning the time and place for conducting examinations. The Service is issuing these regulations pursuant to section 6228(b) of Subtitle J, Title VI of the Technical and Miscellaneous Revenue Act of 1988, the Omnibus Taxpayer Bill of Rights. The regulations set forth general criteria to be utilized by Internal Revenue Service officers and employees in setting a time and place of examination that are reasonable under the circumstances. It is the goal of these regulations to balance the convenience of the taxpayer with the requirements of sound and efficient tax administration. These temporary regulations also cross-reference a notice of proposed rulemaking in *** [GL-705-88, page 632, this Bulletin].

EFFECTIVE DATE: The regulations as to time and place of examination are effective as of April 3, 1990.

SUPPLEMENTARY INFORMATION:

Background

This document contains temporary regulations amending the Procedure and Administration Regulations (26 CFR Part 301) under section 7605 of the Internal Revenue Code. Section 7605(a) of the Internal Revenue Code states that the time and place of examination pursuant to the provisions of section 6420(e)(2), 6421(g)(2), 6427(j)2), or 7602 shall be such time and place as may be fixed by the Secretary and as are reasonable under the circumstances. The existing regulations provide, in general terms, that the time and place for examination shall be fixed by an officer or employee of the Internal Revenue Service and shall be reasonable under the circumstances.

Section 6228(b) of Subtitle J, Title VI of the Technical and Miscellaneous Revenue Act of 1988, the Omnibus Taxpayer Bill of Rights, directs that additional regulations be promulgated governing the setting of the time and place for examinations. In keeping with both the spirit of that legislation and the policy of the Service, it is the goal of these regulations that the Service officer or employee setting the time and place for examination will in all cases balance the convenience of the taxpayer with the requirements of sound and efficient tax administration.

Need for Temporary Regulations

The provisions contained in this Treasury decision are needed to promulgate temporary regulations immediately in response to enactment of section 6228(b) of the Technical and Miscellaneous Revenue Act of 1988. It is therefore found impracticable and contrary to the public interest to issue this Treasury decision with prior notice and public procedure under section 553(b) of Title 5 of the United States Code.

Explanation of Provisions

The current regulations under section 7605 of the Internal Revenue Code permit an officer or employee of the Internal Revenue Service to determine the time and place of examination on a case-by-case basis. The existing regulations do not, however, provide guidance as to what is reasonable under the circumstances. The amended regulations set forth standards to be considered by Service officers and employees in determining a reasonable time and place for examination. The amended regulations provide that, based on these standards, Service officers and employees shall endeavor at all times to schedule a time and place that are reasonable under the circumstances. The regulations require the Service officer or employee to exercise sound judgment in applying these standards to the circumstances at hand, balancing the interests of convenience of the taxpayer with the requirements of sound and efficient tax administration.

In view of constraints necessarily placed on the Service, the proposed regulations provide that it will be considered reasonable for the Service to require that an examination be

scheduled on a normally scheduled workday of the Service, during the Service's normal duty hours. Similarly, to permit the administration of the tax code in an orderly manner, the regulations provide that the Service may schedule examinations throughout the year, without making special accommodations to seasonal fluctuations in the taxpayer's or the taxpayer's representative's business. The regulations contemplate the Service will work with taxpayers or their representatives to attempt to minimize any adverse effects from scheduling the date and time of an examination.

Generally, the Service will determine whether an examination will be an office examination (*i.e.*, an examination conducted at a Service office) or a field examination (*i.e.*, an examination conducted at the taxpayer's residence or place of business, or some other location other than a Service office) based upon the complexity of the return and which form of examination will be more conducive to effective and efficient tax administration. The Service will grant a request to hold an office examination at a location other than a Service office in a case of clear need, such as when the taxpayer's advanced age or infirm physical condition makes it unreasonably difficult to travel to a Service office.

With regard to place of examination, the temporary regulations generally provide that the initial determination of where an examination will take place, including the district to which an examination will be assigned, will be made by the Service based upon the address shown on the return for the period selected for examination. Written requests by taxpayers or their representatives to transfer the place for examination will be considered and resolved on a case-by-case basis.

The regulations provide generally that in the case of an office examination (which are performed only with respect to individual taxpayers), the Service will set the place of examination at the Service office within the assigned district that is closest to the taxpayer's residence. If the closest office does not have an examination group or the personnel needed to conduct the examination, however, the Service is generally permitted to schedule the examination at the closest Service office within the assigned district that has an examination group or the appropriate personnel.

With regard to returns selected by the Service for field examinations, the examination generally will take place at the location where the original books, records, and source documents pertinent to the examination are maintained. This will usually be at the taxpayer's residence or principal place of business.

The Service generally will not conduct an examination at the taxpayer's place of business if the business is so small that doing so will essentially require the taxpayer to close the business or would unduly disrupt business operations. The regulations provide for a procedure under which a taxpayer may advise the Service in writing that an examination at the taxpayer's place of business would essentially require closing the business. The Service, upon verification, will then make arrangements to conduct the examination at a Service office within the district in which the original books, records, and source documents are maintained. Notwithstanding that the examination is moved to a Service office, however, the Service will not be precluded from visiting the taxpayer's place of business during the Service's normal duty hours to establish facts which can only be established by a direct visit, such as inventory or asset verifications.

The regulations provide that taxpayers may make written requests to the Service to change the place of examination, and set forth the general criteria to be used by the Service in responding to these requests. In considering requests to change the place of examination, the Service will normally take into account the following factors: the location of the taxpayer's current residence; the location of the taxpayer's current principal place of business; the location at which the taxpayer's books, records, and source documents are maintained; the location at which the Service can perform the examination most efficiently; the resources available at the Service office to which the taxpayer has requested a transfer; and other factors that indicate that conducting the examination at a particular location could pose undue inconvenience to the taxpayer.

The regulations provide that the Service generally will not adjust the place of an examination based upon the location of the place of business of the taxpayer's representative. In addition, the Service may not accommodate a taxpayer's request for transfer when the expiration of the applicable statute of limitations on assessment or collection is less than thirteen months from the date of the taxpayer's written transfer request, unless the taxpayer has agreed to an extension of the limitations period. The Service also is not required to transfer an examination to an office or district that does not have adequate resources available to conduct the examination.

The regulations indicate that, in all circumstances, the Service may take into account the physical safety of its personnel in setting the place of an examination. Therefore, the Service may not be required to conduct a particular examination at the taxpayer's residence or place of business. When it appears that the possibility of physical danger exists, the Service shall transfer the examination to a Service office and may take any other steps reasonably necessary to protect its officers and employees.

The regulations also provide that nothing in the regulations shall be interpreted as preventing the Service from transferring an examination on its own initiative in order to further the effectiveness and efficiency of the examination, based upon the criteria set forth in the regulations.

Examinations which fall under the jurisdiction of the Office of the Assistant Commissioner (International) sometimes involve unique circumstances because of the presence of a taxpayer or a Service officer or employee in a foreign country, because of special treaty provisions, or for other reasons. The regulations provide that the criteria set forth in the regulations generally will be used as guidelines for these examinations. Where, however, there is a conflict between the criteria in the regulations and the established policies and procedures of the Office of the Assistant Commissioner (International), those policies and procedures will govern.

The legislative history of section 6228 of TAMRA indicates that the

provisions relating to taxpayer interviews generally do not apply to criminal investigations. The amended regulations provide that, except for the statutory ten-day period that must be allowed whenever an administrative summons is used, the regulations do not apply to criminal investigations. The criteria set forth in the regulations therefore govern only the time and place of civil examinations under I.R.C. §7602(a).

Special Analyses

It has been determined that these rules are related to agency organization, management, or personnel and are not subject to Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. Additionally, section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

* * * * *

Adoption of Addition to the Regulations

Accordingly, Title 26, Part 301 of the Code of Federal Regulations is amended as follows:

Paragraph 1. The authority citation for Part 301 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. *** §301.7605-1T also issued under section 6228(b) of the Technical and Miscellaneous Revenue Act of 1988.

Par. 2. In §301.7605-1, the heading and text for paragraph (a) are removed and paragraph (a) is reserved.

Par. 3. Section 301.7605-1T is added immediately following §301.7605-1 to read as follows:

§301.7605-1T Time and place of examination (temporary).

(a)(1) *In general.* The time and place of examination pursuant to the provisions of sections 6420(e)(2), 6421(g)(2), 6427(j)(2), or 7602 of the Internal Revenue Code shall be such time and place as are fixed by an officer or employee of the Internal Revenue Service, and officers and employees shall endeavor at all times to schedule a time and place that are reasonable under the circumstances. This regulation sets forth general criteria for the Service to apply in determining whether a particular time and place for an examination are reasonable under the circumstances. Officers and employees should exercise sound judgment in applying these criteria to the circumstances at hand and should balance convenience of the taxpayer with the requirements of sound and efficient tax administration.

(2) *International examinations.* The criteria in these regulations generally will be used as guidelines for setting the time and place for examinations which fall under the jurisdiction of the Office of the Assistant Commissioner (International). However, if there is a conflict between these regulations and the established policies and procedures of the Office of the Assistant Commissioner (International), the policies and procedures of the Office of the Assistant Commissioner (International) will govern.

(3) *Criminal investigations.* Except for the provisions of paragraph (b)(2) of this section, these regulations do not apply to criminal investigations.

(b) *Time of examination*—(1) *Date and time of examination.* It will be considered reasonable for the Service to schedule the day (or days) for an examination during a normally scheduled workday (or workdays) of the Service, during the Service's normal business hours. It will be considered reasonable for the Service to schedule examinations throughout the year, without reference to seasonal fluctuations in the businesses of particular taxpayers or their representatives. However, the Service will work with taxpayers or their representatives to try to minimize any adverse effects in scheduling the date and time of an examination.

(2) *Date of appearance when summons is used.* In the case of a summons issued under authority of section 7602(a)(2) of the Internal Revenue Code, or under the corresponding authority of sections 6420(e)(2), 6421(g)(2), or 6427(j)(2), the date fixed for appearance before an officer or employee of the Service shall not be less than 10 days from the date of the summons.

(c) *Type of examination*—(1) *In general.* The Service will determine whether an examination will be an office examination (*i.e.*, an examination conducted at a Service office) or a field examination (*i.e.*, an examination conducted at the taxpayer's residence or place of business, or some other location that is not a Service office), based upon the complexity of the return and which form of examination will be more conducive to effective and efficient tax administration.

(2) *Office examination held in location other than Service office in case of clear need.* The Service will grant a request to hold an office examination at a location other than a Service office in a case of clear need, such as when it would be unreasonably difficult for the taxpayer to travel to a Service office because of the taxpayer's advanced age or infirm physical condition.

(d) *Place of examination*—(1) *In general.* The Service will make an initial determination of the place for an examination, including the district to which an examination will be assigned, based upon the address shown on the return for the period selected for examination. Requests by taxpayers to transfer the place of examination will be resolved on a case-by-case basis, using the criteria set forth in paragraph (e) of this section.

(2) *Office examinations.*—(i) *In general.* An office examination will generally take place at the Service office, within the Internal Revenue Service district encompassing the taxpayer's residence, which is closest to the taxpayer's residence. It is generally not reasonable for the Service to require a taxpayer to attend an examination at an office within an assigned district other than the office closest to the taxpayer's residence.

(ii) *Exception.* When the office within the assigned district closest to the taxpayer's residence does not have an examination group or the appropriate personnel to conduct the examination, it generally is reasonable for the Service to require the taxpayer to attend an examination at the office within the assigned district closest to the taxpayer's residence that has an

examination group or the appropriate personnel.

(3) *Field examinations*—(i) *In general.* A field examination will generally take place at the location where the taxpayer's original books, records, and source documents pertinent to the examination are maintained. This will usually be the taxpayer's residence or principal place of business.

(ii) *Exception for certain small businesses*—The Service generally will agree not to conduct an examination at a taxpayer's place of business if the business is so small that doing so would essentially require the taxpayer to close the business or would unduly disrupt business operations. If an examination is scheduled by the Service at the taxpayer's place of business and the taxpayer represents to the Service in writing that conducting the examination at the place of business would essentially require the business to close, the Service, upon verification, shall change the place of examination to a Service office within the Internal Revenue Service district where the taxpayer's books, records, and source documents are maintained.

(iii) *Site visitations.* Regardless of where an examination takes place, the Service may visit the taxpayer's place of business or residence to establish facts that can only be established by direct visit, such as inventory or asset verification. The Service may visit for these purposes on a normal workday of the Service during the Service's normal business hours.

(e) *Requests by taxpayers to change place of examination.*—

(1) *In general.* The Service will consider, on a case-by-case basis, written requests by taxpayers or their representatives to change the place that the Service has set for an examination. In considering these requests, the Service will take into account the following factors:

(i) The location of the taxpayer's current residence;

(ii) The location of the taxpayer's current principal place of business;

(iii) The location at which the taxpayer's books, records, and source documents are maintained;

(iv) The location at which the Service can perform the examination most efficiently;

(v) The resources available at the Service office to which the taxpayer has requested a transfer; and

(vi) Other factors which indicate that conducting the examination at a particular location could pose undue inconvenience to the taxpayer.

(2) *Circumstances in which the Service normally will permit transfers.* A request by a taxpayer to transfer the place of examination will generally be granted under the following circumstances:

(i) *Office examination*—(A) If a taxpayer currently resides in a district other than the district initially selected for the examination, the Service normally will agree to transfer the examination to that Service office, in the district encompassing the taxpayer's current residence, which is closest to the taxpayer's residence.

(B) If a taxpayer's current residence is closer to a different Service office in the same district than the office initially selected for the examination, the Service normally will agree to transfer the examination to the Service office closest to the taxpayer's current residence.

(ii) *Field examinations*—(A) If a taxpayer does not reside at the residence where an examination has been scheduled, the Service will transfer the examination to the taxpayer's current residence.

(B) If a taxpayer's books, records and source documents are maintained at a place other than the place at which the examination is scheduled to take place, the Service will agree to transfer the examination to the place where the taxpayer's books, records and source documents are maintained.

(3) *Transfer for convenience of taxpayer's representative.* The location of the place of business of a taxpayer's representative will generally not be considered in determining the place for an examination.

(4) *Transfer within thirteen months of expiration of limitations period.* If any applicable period of limitations on assessment or collection provided in the Internal Revenue Code will expire within thirteen months from the date of a taxpayer's request to transfer the place of an examination, the Service may require, as a condition for an otherwise permissible transfer, that the taxpayer first agree in writing to extend the limitations period.

(5) *Transfer to office with insufficient resources.* The Service will not be required to transfer an examination to an office or district that does not have adequate resources to conduct the examination.

(f) *Safety of Service officers and employees.* Notwithstanding any other provision of this regulation, officers and employees of the Service may decline to conduct an examination at a particular location if it appears that the possibility of physical danger may exist at that location. In these circumstances, the Service may transfer an examination to a Service office and take any other steps reasonably necessary to protect its officers and employees.

(g) *Transfers initiated by Service.* Nothing in these regulations shall be interpreted as precluding the Service from initiating the transfer of an examination if the transfer would promote the effective and efficient conduct of the examination. Should a taxpayer request that such a transfer not be made, the Service will consider the request according to the principles and criteria set forth in paragraph (e) of this section.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

Approved March 27, 1990.

Kenneth W. Gideon,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on April 2, 1990, 8:45 a.m., and published in the issue of the Federal Register for April 3, 1990, 55 F.R. 12344)

Chapter 79.—Definitions

Section 7701.—Definitions

26 CFR 301.7701-2: Associations.

Limited partnerships. The state of Mississippi is added to the list of states that have enacted legislation that corresponds to the Uniform Lim-

ited Partnership Act for purposes of section 301.7701-2 of the regulations. Rev. Rul. 89-123 amplified.

Rev. Rul. 90-18

In Rev. Rul. 89-123, 1989-2 C.B. 261, the Internal Revenue Service listed all the states whose revised limited partnership acts correspond to the Uniform Limited Partnership Act (ULPA) for purposes of section 301.7701-2 of the Procedure and Administration Regulations.

The Service has determined that the following additional state has enacted legislation that, as of its effective date, corresponds to the ULPA for purposes of section 301.7701-2 of the regulations.

Mississippi: Miss. Code Ann. Chapter 14, sections 79-14-101 through 79-14-1107 (Supp. 1988) effective January 1, 1988.

EFFECT ON OTHER RULINGS

Rev. Rul. 89-123 is amplified.

Subchapter 80.—General Rules

Subchapter A.—Application of Internal Revenue Laws

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

A taxpayer may not, without the Commissioner's consent, retroactively change from an erroneous to a permissible method of accounting by filing amended returns, even if the period for amending the return for the first year in which the erroneous method was used has not expired. Relief is granted under section 7805(b) of the Code for amended returns filed in reliance on Rev. Rul. 70-539, 1970-2 C.B. 70, before April 30, 1990, to correct an impermissible capitalization method under section 266. See Rev. Rul. 90-38, page 57.

Subchapter C.—Provisions Affecting More Than One Subtitle

Section 7872.—Treatment of Loans with Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 1990. See Rev. Rul. 90-1, page 155.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1990. See Rev. Rul. 90-12, page 156.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 1990. See Rev. Rul. 90-22, page 158.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 1990. See Rev. Rul. 90-28, page 159.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of May 1990. See Rev. Rul. 90-41, page 161.

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 1990. See Rev. Rul. 90-48, page 162.

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26 CFR 1.9100-1: Extensions of time for making elections.

Revised procedures are provided for issuing rulings and determination letters in response to applications for recognition of exemption from federal income tax. See Rev. Proc. 90-27, page 514.

Part II. Treaties and Tax Legislation

CONTENTS

Subpart A.—Tax Conventions

Agreement Between the United States and the United Mexican States 196

Agreement Between the United States and the Commonwealth of Puerto Rico 199

Subpart B.—Legislation and Related Committee Reports

Public Law 101-73 (H.R. 1278) 204

Public Law 101-140 (H.J. Res. 280) 207

Public Law 101-194 (H.R. 3660) 209

Public Law 101-239 (H.R. 3299) 210

AGREEMENT BETWEEN THE UNITED STATES OF AMERICA AND THE UNITED MEXICAN STATES FOR THE EXCHANGE OF INFORMATION WITH RESPECT TO TAXES[1]

The United States of America and the United Mexican States, desiring to conclude an Agreement for the exchange of information with respect to taxes (hereinafter referred to as the "Agreement"), have agreed as follows:

Article 1
OBJECT AND SCOPE

1. The objective of this Agreement is to facilitate the exchange of information between the Contracting States on the assessment and collection of taxes, with a view to better enable them to prevent, within their respective jurisdictions, fiscal evasion and fraud, and develop improved information sources for tax matters.

2. The Contracting States shall cooperate with each other to carry out the objective of this Agreement, in conformity with and subject to the limitations of their respective national laws and regulations.

3. Pursuant to the provision of paragraph 2 of this Article, requests for assistance under this Agreement will be executed, except to the extent that:

a) execution of the request would require the requested State to exceed its legal authority or would otherwise be prohibited by legal provisions in force in that State, or when the information requested is not obtainable under the laws or in the normal course of the administration of the requested state or of the other Contracting State, in which case the competent authorities of both Contracting States shall consult with each other to agree upon alternative lawful means for securing assistance;

b) execution of the request would in the judgment of the requested State be contrary to its national security or public policy;

c) to supply information would disclose any trade, business, industrial, commercial, or professional secret or trade process;

d) to supply information requested by the applicant State to administer or enforce a provision of the tax law of the applicant State, or any requirement connected therewith, would discriminate against a national of the requested State. A provision of tax law, or connected requirement, will be considered to be discriminatory against a national of the requested State if it is more burdensome with respect to a national of the requested State than with respect to a national of the applicant State in the same circumstances. For purposes of the preceding sentence, a national of the applicant State who is subject to tax on worldwide income is not in the same circumstances as a national of the requested State who is not subject to such taxation. The provision of this subparagraph shall not be construed to prevent the exchange of information with respect to the taxes imposed by the United States or Mexico on branch profits or the excess interest of a branch or on the premium income of foreign insurers;

e) the request does not comply with the provisions of this Agreement.

4. The Contracting States shall provide assistance through exchange of information authorized pursuant to Article 4 and such related measures as may be agreed upon by the competent authorities pursuant to Article 5.

5. Information shall be exchanged to fulfill the purpose of this Agreement without regard to whether the person to whom the information relates is, or whether the information is held by, a resident or national of Contracting State.

Article 2
TAXES COVERED

1. This Agreement shall apply to the following taxes imposed by or on behalf of a Contracting State:

a) in the case of the United States of America,

(i) Federal income taxes,

(ii) Federal taxes on employment income,

(iii) Federal taxes on transfers to avoid income tax,

(iv) Federal estate and gift taxes,

(v) Federal excise taxes; and

b) in the case of Mexico,

(i) Federal income taxes,

(ii) Federal taxes on employment income,

(iii) Federal taxes on business assets,

(iv) Federal value added taxes, and

(v) Federal excise taxes.

2. This Agreement shall apply also to any identical or substantially similar taxes imposed after the date of signature of the Agreement in addition to or in place of the existing taxes. The competent authority of each Contracting State shall notify the other of changes in laws which may affect the obligations of that State pursuant to this Agreement.

3. This Agreement shall not apply to the extent that an action or proceeding concerning taxes covered by this Agreement is barred by the applicant State's statute of limitations.

4. This Agreement shall not apply to taxes imposed by states, municipalities or other political subdivisions, or possessions of a Contracting State.

Article 3
DEFINITIONS

1. In this Agreement, unless otherwise defined:

a) The term "competent authority" means:

(i) in the case of the United States of America, the Secretary of the Treasury or his delegate, and

(ii) in the case of Mexico, the Secretary of Finance and Public Credit or his delegate.

b) The term "national" means:

(i) in the case of the United States, any United States citizen and any legal person, partnership, corporation, trust, estate, association, or other entity deriving its status as such from the laws in force in the United States; and

(ii) in the case of Mexico, any Mexican citizen and any legal

[1]Diplomatic notes were exchanged January 18, 1990 per Treasury News NB-654, dated February 5, 1990.

person, partnership, corporation, trust, estate, association, or other entity deriving its status as such from the laws in force in Mexico.

c) The term "person" includes an individual and any legal person, including a partnership, corporation, trust, estate, or association.

d) The term "tax" means any tax to which the Agreement applies.

e) The term "information" means any fact or statement, in any form whatever, that may be relevant or material to tax administration and enforcement, including (but not limited to):

(i) testimony of an individual, and

(ii) documents, records or other personal property of a person or Contracting State.

f) The terms "applicant State" and "requested State" mean, respectively, the Contracting State applying for or receiving information and the Contracting State providing or requested to provide such information.

g) For purposes of determining the geographical area within which jurisdiction to compel production of information may be exercised, the term "United States" means the United States of America.

h) For purposes of determining the geographical area within which jurisdiction to compel production of information may be exercised, the term "Mexico" means the United Mexican States.

2. Any term not defined in this Agreement, unless the context otherwise requires or the competent authorities agree to a common meaning pursuant to the provisions of Article 5, shall have the meaning which it has under the laws of the Contracting State relating to the taxes which are the subject of this Agreement.

Article 4

EXCHANGE OF INFORMATION

1. The competent authorities of the Contracting States shall exchange information to administer and enforce the domestic laws of the Contracting States concerning taxes covered by this Agreement, including information to effect the determination, assessment, and collection of tax, the recovery and enforcement of tax claims, or the investigation or prosecution of tax crimes or crimes involving the contravention of tax administration.

2. The competent authorities of the Contracting States shall automatically transmit information to each other for the purposes referred to in paragraph 1. The competent authorities shall determine the items of information to be exchanged pursuant to this paragraph and the procedures to be used to exchange such items of information.

3. The competent authority of a Contracting State shall spontaneously transmit to the competent authority of the other State information which has come to the attention of the first-mentioned State and which is likely to be relevant to, and bear significantly on, accomplishment of the purposes referred to in paragraph 1. The competent authorities shall determine the information to be exchanged pursuant to this paragraph and take such measures and implement such procedures as are necessary to ensure that the information is forwarded to the competent authority of the other State.

4. The competent authority of the requested State shall provide information upon request by the competent authority of the applicant State for the purposes referred to in paragraph 1. If the information available in the tax files of the requested State is not sufficient to enable compliance with the request, that State shall take all relevant measures to provide the applicant State with the information requested.

a) The requested State shall have or has the authority to:

(i) examine any books, papers, records, or other tangible property which may be relevant or material to such inquiry;

(ii) question any person having knowledge or in possession, custody or control of information which may be relevant or material to such inquiry to appear at a stated time and place and testify under oath and produce books, papers, records, or other tangible property;

(iii) compel any person having knowledge or in possession, custody or control of information which may be relevant or material to such inquiry to appear at a stated time and place and testify under oath and produce books, papers, records, or other tangible property;

(iv) take such testimony of any individual under oath.

b) If the United States is requested to obtain the types of information covered by section 3402 of the Right of Financial Privacy Act of 1978 (12 USCA 3402) as in effect at the time of signing this Agreement, it shall obtain the requested information pursuant to that provision. If Mexico is requested to obtain the types of information covered by Article 93 of the Regulatory Law of Banking and Credit Public Service as in effect at the time of signing this Agreement, it shall obtain the requested information pursuant to that provision. Laws or practices of the requested State do not prevent or otherwise affect the authority of the competent authority of the requested State to obtain and provide the types of information covered by the abovecited provisions pursuant to the Agreement.

c) Privileges under the laws or practices of the applicant State shall not apply in the requested State in the execution of a request. Claims of privilege under the laws or practices of the applicant State shall be determined exclusively by the courts of that State, and claims of privilege under the laws or practices of the requested State shall be determined exclusively by the courts of that State.

5. If information is requested by a Contracting State pursuant to paragraph 4, the requested State shall obtain the information requested in the same manner, and provide it in the same form, as if the tax of the applicant State were the tax of the requested State and were being imposed by the requested State. However, if specifically requested by the competent authority of the applicant State, the requested State shall:

a) specify the time and place for the taking of testimony or the production of books, papers, records, and other tangible property;

b) place the individual giving testimony or producing books, papers, records and other tangible property under oath;

c) permit the presence of individuals designated by the competent authority of the applicant State as being involved in or affected by execution of the request. The individual giving testimony or the accused may be accompanied by his counsel;

d) provide such individuals described in subparagraph c) with an opportunity to question the individual giving testimony or producing books, papers, records and other tangible property:

i) if Mexico is the applicant State, directly or through the executing authority; and

ii) if the United States is the applicant State, through the executing authority;

e) secure original and unedited books, papers, and records, and other tangible property;

f) secure or produce true and correct copies of original and unedited books, papers and records;

g) determine the authenticity of books, papers, records and other tangible property produced;

h) examine the individual producing books, papers, records and other tangible property regarding the purpose for which and the manner in which the item produced is or was maintained;

i) permit the competent authority of the applicant State to provide written questions through the executing authorities of the requested State to which the individual producing books, papers, records and other tangible property is to respond regarding the item produced;

j) perform any other act not in violation of the laws or at variance with the administrative practice of the requested State;

k) certify either that procedures requested by the competent authority of the applicant State were followed or that the procedures requested could not be followed, with an explanation of the deviation and the reason therefore.

6. The provisions of the preceding paragraphs shall be construed so as to impose on a Contracting State the obligation to use all legal means and its best efforts to execute a request. A Contracting State may, in its discretion, take measures to obtain and transmit to the other State information which, pursuant to paragraph 3 of Article 1, it has no obligation to transmit.

7. Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to individuals or authorities (including judicial and administrative bodies) involved in the determination, assessment, collection, and administration of, the recovery and collection of claims derived from, the enforcement or prosecution in respect of, or the determination of appeals in respect of, the taxes which are the subject of this Agreement, or the oversight of the above. Such individuals or authorities shall use the information only for such purposes. These individuals or authorities may disclose the information in public court proceedings or in judicial decisions.

Article 5
MUTUAL AGREEMENT PROCEDURE

1. The competent authorities of the Contracting States shall agree to implement a program to carry out the purposes of this Agreement. This program may include, in addition to exchanges specified in Article 4, other measures to improve tax compliance, such as exchanges of technical know-how, development of new audit techniques (including simultaneous examinations and simultaneous criminal investigations in their respective jurisdictions and by their respective competent authorities), identification of new areas of non-compliance, and joint studies of non-compliance areas.

2. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of this Agreement. In particular, the competent authorities may agree to a common meaning of a term and may determine when costs are extraordinary for purposes of Article 6.

3. The competent authorities of the Contracting States may communicate with each other directly for the purposes of reaching an agreement under this Article.

Article 6
COSTS

Unless the competent authorities of the Contracting States otherwise agree, ordinary costs incurred in providing assistance shall be borne by the requested State and extraordinary costs incurred in providing assistance shall be borne by the applicant State.

Article 7
ENTRY INTO FORCE

This Agreement shall enter into force upon an exchange of notes by the duly authorized representatives of the Contracting States confirming their mutual agreement that both sides have met all constitutional and statutory requirements necessary to effectuate this Agreement.

Article 8
TERMINATION

This Agreement shall remain in force until terminated by one of the Contracting States. Either Contracting State may terminate the Agreement at any time after the Agreement enters into force provided that at least 3 months prior notice of termination has been given through diplomatic channels.

DONE at Washington, D.C. in duplicate, in the English and Spanish languages, the two texts having equal authenticity, this 9th day of November, 1989.

FOR THE UNITED STATES OF AMERICA:

Nicholas F. Brady

FOR THE UNITED MEXICAN STATES:

Pedro Aspe Armella

TAX COORDINATION AGREEMENT BETWEEN THE UNITED STATES OF AMERICA AND THE COMMONWEALTH OF PUERTO RICO

The Government of the United States of America and the Government of the Commonwealth of Puerto Rico desiring to conclude an Agreement (hereinafter referred to as the "Agreement") for the exchange of information and mutual assistance with respect to taxes in order to prevent the evasion or avoidance of United States or Commonwealth of Puerto Rico taxes have agreed as follows:

Article 1
SCOPE OF AGREEMENT

This Agreement is intended to provide for mutual assistance in tax matters, including exchanges of information, for purposes of administering the tax laws of the respective Governments and especially to prevent avoidance or evasion of the Governments' respective fiscal laws. The provisions of this Agreement are subject to provisions of the statutes, regulations, and published procedures of the Contracting Governments.

Upon entry into force, this Agreement replaces any and all prior tax coordination agreements between the respective Governments.

Article 2
TAXES COVERED

1. This Agreement shall apply to the following taxes imposed by or on behalf of a Contracting Government:

a) in the case of the United States of America, all taxes imposed by the Code, and

b) in the case of the Commonwealth of Puerto Rico, all taxes imposed by the Income Tax Act of 1954 as amended.

2. This Agreement shall apply also to any identical or substantially similar taxes imposed after the date of signature of the Agreement in addition to or in place of the existing taxes. The competent authority of each Government shall notify the other of significant changes in laws which may affect the obligations of that Government pursuant to this Agreement.

3. This Agreement shall not apply to the extent that an action or proceeding concerning taxes covered by this Agreement is barred by the applicant Government's statute of limitations.

Article 3
DEFINITIONS

1. In this Agreement, unless otherwise defined:

a) The term "Code" shall mean the Internal Revenue Code of 1986, as amended, and any predecessor or successor statutes.

b) The term "competent authority" means:

(i) in the case of the United States of America, the Secretary of the Treasury or his delegate, and

(ii) in the case of the Commonwealth of Puerto Rico, the Secretary of the Treasury or his delegate.

c) The term "Contracting Government" means the United States or the Commonwealth of Puerto Rico as the context requires.

d) The term "non-Commonwealth of Puerto Rico source income" means income for which the source (under source rules promulgated by the U.S. Internal Revenue Service) is not the Commonwealth of Puerto Rico.

e) The term "person" includes an individual and a partnership, corporation, company, trust, estate, association or other legal entity.

f) The term "tax" means any tax to which the Agreement applies.

g) The term "taxpayer" means:

(i) in the case of the United States, any person subject to the provisions of the Code, and

(ii) in the case of the Commonwealth of Puerto Rico, any person subject to the provisions of any tax administered by the Commonwealth of Puerto Rico.

h) For purposes of determining the geographical area in respect of which jurisdiction to compel production of information under this Agreement may be exercised, the term "United States" means the United States of America, including the Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and any other United States possession or territory and the territorial waters thereof, but not including the Commonwealth of Puerto Rico. Such jurisdiction may be exercised if the information or the custodian of the information is located within the United States.

i) For purposes of determining the geographical area in respect of which jurisdiction to compel production of information under this Agreement may be exercised, the term "the Commonwealth of Puerto Rico" means the territorial domain, lands and waters acquired by the United States through cession as the island of Puerto Rico in the West Indies by convention between the United States of America and the Kingdom of Spain entered into December 10, 1898, and ratified by the United States on February 6, 1899. Such jurisdiction may be exercised if the information or the custodian of the information is located within the Commonwealth of Puerto Rico.

2. Any term not defined in this Agreement, unless the context otherwise requires or the competent authorities agree to a common meaning pursuant to the provisions of Article 5, shall have the meaning which it has under the laws of the Contracting Governments relating to the taxes which are the subject of this Agreement.

Article 4
EXCHANGE OF INFORMATION

1. The competent authorities of the Contracting Governments shall exchange information to administer and

enforce the domestic laws of the Contracting Governments concerning taxes covered by this Agreement. Information shall be exchanged to fulfill the purposes of this Agreement without regard to whether the information relates to, or is held by, a taxpayer of a Contracting Government. Procedures for exchange of information are set forth in Appendix A, Limitations on Disclosure of Tax Information, which is incorporated by reference and made a part of this Agreement.

2. The competent authorities of the Contracting Governments shall automatically transmit information to each other for the purposes referred to in paragraph 1. The competent authorities shall determine the items of information to be exchanged pursuant to this paragraph and the procedure to be used to exchange such items of information.

a) It is intended that the United States shall routinely supply to the Commonwealth of Puerto Rico the following information, to the extent available and subject to the tolerances and criteria to be agreed upon by the competent authorities:

(i) copies of reports of individual, partnership, corporate, and employment audit changes that disclose information relevant to the Commonwealth of Puerto Rico;

(ii) copies of Forms 5335 (Income Subject to Withholding under Chapter 3, Internal Revenue Code, as reported on Form 1042S, and any successor or comparable forms) that disclose information relevant to the Commonwealth of Puerto Rico;

(iii) copies of Schedule K-1 of Form 1065 (U.S. Partnership Return of Income) and audit results, when the partnership return is examined and it appears the examination will affect returns of the Commonwealth of Puerto Rico taxpayers;

(iv) copies of responses to Forms 4901, 4902, and 4903, Requests for Information About Tax Forms, where such reply indicates that the taxpayer has filed a return with the Commonwealth of Puerto Rico;

(v) copies of Forms 1099 and all other information returns where the recipient of income is a Commonwealth of Puerto Rico resident or lists a Commonwealth of Puerto Rico address or the income is from the Commonwealth of Puerto Rico sources;

(vi) copies of the W-2 combined wage reporting tape summarizing Forms W-2PR (Puerto Rico Wage and Tax Statement) and Forms W-3PR (Transmittal of Wage and Tax Statements) filed with the Social Security Administration by employers in the Commonwealth of Puerto Rico, which tape is provided annually to the Internal Revenue Service by the Social Security Administration; and copies of the 1040PR.

b) It is intended that the Commonwealth of Puerto Rico shall routinely supply to the United States the following information, to the extent available and subject to the tolerances and criteria to be agreed upon by the competent authorities:

(i) copies of reports of individual, partnership, corporate, and employment audit changes that disclose information relevant to the United States;

(ii) information about the ownership interests of all corporations subject to the Commonwealth of Puerto Rico tax with non-Commonwealth of Puerto Rico source income that receive a reduction of the Commonwealth of Puerto Rico taxes;

(iii) such information about corporations electing application of section 936 of the Code as may be agreed upon by the competent authorities; and

(iv) information about any reductions of tax provided by the Commonwealth of Puerto Rico for income derived by a Commonwealth of Puerto Rico taxpayer from other United States possessions or territories.

c) The competent authorities of the Contracting Governments may agree to expand or limit the information to be routinely exchanged.

3. The competent authority of a Contracting Government shall spontaneously transmit to the competent authority of the other Government information which has come to the attention of the first-mentioned Government and which is likely to be relevant to, and bear significantly on, administration and enforcement of the domestic laws concerning taxes of the second-mentioned Government. The competent authorities shall determine the information to be exchanged pursuant to this paragraph and take such measures and implement such procedures as are necessary to ensure that the information is forwarded to the competent authority of the other Government.

4. The competent authority of the requested Government shall endeavor to provide information upon request by the competent authority of the applicant Government for the administration and enforcement of the domestic laws of the Contracting Governments concerning taxes. If the information available in the tax files of the requested Government is not sufficient to enable compliance with the request, that Government shall take the necessary measures to provide the applicant Government with the information requested. Notwithstanding the foregoing, the United States may exercise its rights under section 7602 *et seq.* of the Code to obtain information in the Commonwealth of Puerto Rico without resorting to the procedures set forth in this Agreement. However, in the event the United States so exercises its rights within the Commonwealth of Puerto Rico, it shall notify the competent authority of the Commonwealth of Puerto Rico prior to taking action or as soon as practicable, unless the competent authorities agree to limit

notification with respect to certain classes of cases.

5. The provisions of the preceding paragraphs shall not be construed so as to impose on a Contracting Government the obligation:

a) to supply particular items of information which are not obtainable under the laws of that Government or of the other Contracting Government;

b) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process;

c) to supply information, the disclosure of which would be contrary to public policy; or

d) to disclosure information if such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.

6. Any information received by a Contracting Government shall be subject to Appendix A, Limitations on Disclosure of Tax Information.

Article 5
MUTUAL AGREEMENT PROCEDURE AND COSTS

1. The competent authorities of the Contracting Governments shall implement a program to carry out the purposes of this Agreement. In particular, the competent authorities of the Contracting Governments may amend Appendix A as they deem necessary within the limitations of this Agreement and the Code.

2. The competent authorities of the Contracting Governments shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of this Agreement and may communicate directly for this purpose. In particular, the competent authorities may agree to the common meaning of a term and may determine when costs are extraordinary for purposes of this Article.

3. Unless the competent authorities of the Contracting Governments otherwise agree, ordinary costs incurred in providing assistance shall be borne by the requested Government and extraordinary costs incurred in providing assistance shall be borne by the applicant Government. The competent authorities of the Contracting Governments may agree not to charge each other for the costs of reproduction of information routinely exchanged.

Article 6
MUTUAL AGREEMENT PROCEDURE ON POTENTIAL DOUBLE TAXATION

1. When by reason of inconsistent positions taken by the Contracting Governments, a taxpayer is or would be subject to inconsistent tax treatment by the two jurisdictions, the competent authorities of the Contracting Governments shall endeavor to agree upon the facts and circumstances necessary to achieve consistent application of the tax laws of the respective Governments. In particular, but not by way of limitation, the competent authorities of the Contracting Governments may consult together to endeavor to agree:

a) To the same allocation of income under section 482 of the Code or similar provisions under the tax laws applicable to taxpayers in the Commonwealth of Puerto Rico;

b) To the same determination of residency of a particular taxpayer; or

c) To the same determination of the source of particular items of income.

Article 7
OTHER APPLICATIONS OF AGREEMENT

1. The Contracting Governments agree that when they have knowledge that a taxpayer has changed residence from one taxing jurisdiction to the other and seeks to change methods of accounting (or to make an initial election), no such change or election shall be permitted until the competent authorities have consulted and determined that such change or election will not lead to the evasion or avoidance of taxes imposed by either of the Contracting Governments. This paragraph includes initial adoption of an accounting method or an election inconsistent with a method or election previously utilized in the other jurisdiction by the taxpayer.

2. The Contracting Governments agree that a Puerto Rico corporation owned or controlled directly or indirectly by a person whose beneficial ownership is undisclosed (such as through bearer shares) shall be treated as owned or controlled to that extent by a foreign person for purposes of the respective Governments' tax laws.

3. The Contracting Governments agree that for purposes of determining whether a person qualifies as a bona fide resident of the Commonwealth of Puerto Rico under section 933 of the Code the definition to be used shall be the definition contained in the then-applicable regulations promulgated by the United States.

4. Any taxpayer information disclosed to the United States shall become "taxpayer return information" as defined by section 6103(b)(3) of the Code and may be redisclosed only in accordance with provisions of the Code or an applicable treaty.

5. Subject to the restrictions and other provisions of this Agreement and the availability of enforcement resources, the competent authorities will develop a cooperative return selection and examination program with the objective of avoiding unnecessary duplication of examination coverage.

6. Subject to the restrictions and other provisions of this Agreement, the Contracting Governments will develop a simultaneous examination program for both civil and criminal investigations.

7. In addition to the exchange of tax and other information, the competent authorities will, to the extent feasible, extend to each other assistance in other tax administration matters. This may include such activities as taxpayer assistance, stocking tax forms for the public, training of personnel, preparing special statistical studies and compilations of data, and development and improvement of tax administration systems and procedures, as well as such other activities as may improve tax administration.

Article 8
ENTRY INTO FORCE

This Agreement shall enter into force upon signature by the duly authorized representatives of the Contracting Governments.

Article 9
AMENDMENT AND TERMINATION

1. This Agreement may be modified or amended by mutual consent of the Contracting Governments.

2. This agreement shall remain in force until terminated by one of the Contracting Governments. Either Contracting Government may terminate the Agreement at any time after the Agreement enters into force provided that at least 6 months' prior notice of termination has been given.

3. Any unauthorized use or disclosure of Federal returns or Federal return information as defined in section 6103(b)(1) and (2) of the Code furnished pursuant to this Agreement or inadequate procedures for safeguarding the confidentiality of such returns and return information, constitutes grounds for immediate termination of this Agreement and the exchange of information thereunder, subject to the rights of administrative appeal as provided by regulations prescribed by section 6103(p)(7) of the Code.

DONE by the Government of the Commonwealth of Puerto Rico at _____, in duplicate, this ____ day of ____, 1989.

FOR THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO:

Rafael Hernández Colón,
Governor.

J. Agosto,
Secretary of the Treasury.

DONE by the Government of the United States of America at Washington, D.C., in duplicate, this 26th day of May, 1989.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:

Michael J. Murphy,
Acting Commissioner of Internal Revenue.

APPENDIX A
LIMITATIONS ON DISCLOSURE OF TAX INFORMATION

SECTION 1. Definitions

For purposes of this appendix, the following definitions apply:

1.1 Hacienda. The term "Hacienda" means the Department of the Treasury of the Commonwealth of Puerto Rico.

1.2 IRS. The term "IRS" means the Internal Revenue Service, U.S. Department of Treasury.

1.3 Possession Audit Agency. The term "Possession Audit Agency" means the agency, body or commission which is charged under the laws of the Commonwealth of Puerto Rico with the responsibility of auditing Possession revenues and programs.

1.4 Possession. The term "Possession" means the Commonwealth of Puerto Rico of the United Staes.

1.5 Hacienda Representative. The term "Hacienda Representative" means a Hacienda officer or employee designated in writing by the head of the Hacienda, to the Assistant Commissioner (International) at Washington, D.C. and the Service Center Director at Philadelphia, PA, as an individual who is to inspect or receive Federal returns or Federal return information on behalf of the Hacienda as provided by section 6103(d) of the Code, but only so long as the duties and employment of such officer or employee require access to Federal returns and Federal return information for purposes of Possession tax administration.

1.6 IRS Representative. The term "IRS Representative" means an officer or employee of the IRS who has been designated in writing to the head of the Hacienda by the Assistant Commissioner (International) at Washington, D.C., or the Service Center Director at Philadelphia, PA, as an individual who is to inspect or receive Possession returns or Possession return information on behalf of the IRS, but only so long as the duties and employment of such officer or employee require access to Possession returns and return information for the purpose of Federal tax administration.

1.7 Federal Return. The term "Federal Return" is defined in the same manner as provided in section 6103(b)(1) of the Code.

1.8 Federal Return Information. The term "Federal Return Informatin" is defined in the same manner as provided in section 6103(b)(2) of the Code. However, "Federal Return Information" does not include information in the hands of the Possession which it obtained wholly from sources independent from the IRS.

1.9 Possession Return. The term "Possession Return" is defined in the same manner as provided in section 6103(b)(1) of the Code as it applies in the Commonwealth of Puerto Rico.

1.10 Possession Return Information. The term "Possession Return Information" means a taxpayer's identity, the nature, source, or amount of his/her income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer's Possession return was, is being, or will be examined or subject to other investigation or processing, or any other data received by, recorded by, prepared by, furnished to, or collected by the Hacienda with respect to a Possession return or with respect to determination of the existence, or possible existence, of liability (or the amount thereof) of any person under the internal revenue laws, or related statutes, of the Possession, for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.

1.11 Inspection. The term "Inspection" means any examination of a return or return information.

1.12 Disclosure. The term "Disclosure" means the making known to any person in any manner whatever a return or return information.

1.13 Possession Tax Administration. The term "Possession Tax Administration"

(a) means—

(i) the administration, management, conduct, direction, and supervision of the execution and application of the revenue laws, or related statutes of the Possession, and

(ii) the development and formulation of Possession tax policy relating to existing or proposed internal revenue laws, or related statutes, of the Possession; and

(b) includes assessment, collection, enforcement, litigation, publication, and statistical-gathering functions under such laws or statutes.

1.14 Code. The term "Code" means the Internal Revenue Code of 1986, as amended, and any predecessor or successor statutes.

SECTION 2. Disclosure of Federal Returns and Federal Return Information

2.1 Pursuant to the laws of the Possession, the Hacienda is charged

with the responsibility for the administration of Possession taxes imposed on income, inheritance, gifts, real property and excise taxes on imports used in the conduct of a trade or business. Federal returns, and Federal return information (whether originals, paper copy, photocopy, microfilm, magnetic media, or any other form) received from the IRS will be used for the purpose of, and only to the extent necessary in, Possession tax administration.

2.2 This Agreement and Appendix constitute the requisite authorization pursuant to section 6103(d)(1) of the Code for the IRS to disclose to, and permit inspection by, a Hacienda Representative of Federal returns and Federal return information relating to taxes imposed by chapters one, two, six, eleven, twelve, twenty-one, twenty-three, twenty-four, thirty-one, thirty-two, forty-four, forty-five, fifty-one, fifty-two, and subchapter D of chapter thirty-six of the Code.

2.3 Upon the occurrence of any change in employment, duties, or other relevant matters affecting a Hacienda Representative's right to access to Federal returns and Federal return information or status as a Hacienda Representative, the head of the Hacienda shall promptly advise in writing the Assistant Commissioner (International) at Washington, D.C. and the Service Center Director at Philadelphia, PA, that such individual is no longer a Hacienda Representative.

2.4 A Hacienda Representative to whom a Federal return or Federal return information had been disclosed may thereafter disclose such return or return information:

(a) to another employee of the Hacienda for the purpose of and only to the extent necessary in the administration of the Possession tax laws for which the Hacienda is responsible;

(b) to a person described in section 6103(n) of the Code or to any officer or employee of such person, solely for the purpose of Possession tax administration and in a manner consistent with applicable regulations, published rules or procedures, or written communications;

(c) to a legal representative of the Hacienda personally and directly engaged in, and solely for use in, preparation for a civil or criminal proceeding (or investigation which may result in a proceeding) before a Possession administration body, grand jury, or court in a matter involving Possession tax administration, if the returns and return information satisfy one or more of the criteria established in section 6103(h)(4)(A), (B) or (C); and

(d) to an officer or employee of the Possession audit agency for the purpose of and only to the extent necessary in making an audit of the Hacienda.

2.5 A Federal return or Federal return information may be disclosed in a judicial or administrative proceeding pertaining to Possession tax administration, but only if the criteria established in section 6103(h)(4)(A), (B) or (C) of the Code are met.

2.6 Notwithstanding any other provision of this section, the IRS will not disclose a Federal return or Federal return information under this section if such disclosure would identify a confidential informant or seriously impair a Federal civil or criminal tax investigation. The Hacienda agrees that neither it nor its legal representatives will make any further use or disclosure of a Federal return or Federal return information disclosed to a Hacienda Representative by the IRS if the IRS notifies the head of the Hacienda in writing that such further use or disclosure would identify a confidential informant or seriously impair a Federal civil or criminal tax investigation. The Hacienda further agrees that prior to the disclosure of any Federal return or Federal return information in a Possession judicial proceeding or to any party other than the taxpayer or his/her designee in a Possession administrative proceeding if the return or return information satisfies one or more of the criteria established in section 6103(h)(4)(A), (B) or (C) of the Code, the head or legal representative of the Hacienda will notify in writing the Service Center Director or Assistant Commissioner (International), from whom the return or return information was received, of the intention to make such disclosure. No officer, employee or legal representative shall disclose a Federal return or Federal return information in a Possession judicial or administrative proceeding if the Service Center Director or Assistant Commissioner (International) or their delegate, within 30 days following receipt of such written notice, informs the head or legal representative of the Hacienda that such disclosure would identify a confidential informant or seriously impair a Federal civil or criminal tax investigation.

2.7 Additionally, the Hacienda agrees that it will notify the Assistant Commissioner (International) when, during an audit of the Hacienda by the Possession Audit Agency, Federal returns and Federal return information are disclosed to the Possession Audit Agency and such information is made part of the Possession Audit Agency's workpapers.

SECTION 3. Disclosure of Possession Returns and Possession Return Information

3.1 This Agreement and Appendix constitute the requisite authorization for the Hacienda to disclose to, and permit inspection by, IRS Representatives of Possession returns and Possession return information for the purpose of, and only to the extent necessary in the administration of the internal revenue laws, or related statutes, of the United States. Any Possession returns and Possession return information so disclosed to, or inspected by, an IRS Representative become, in the hands of the IRS, "taxpayer return information" as defined by section 6103(b)(3) of the Code and may be redisclosed by the IRS only in accordance with provisions of the Code or an applicable treaty.

SECTION 4. Safeguards and Other Requirements

4.1 As an express condition for the inspection and disclosure of Federal returns and Federal return information, the Hacienda agrees to comply with the safeguards and requirements prescribed by section 6103(p)(4) of the Code and any implementation of such safeguards and requirements as may be provided by regulations and published procedures including:

(a) furnishing an annual report to the IRS describing the procedures established and utilized by the Hacienda for ensuring the confidentiality of such returns and return information;

(b) permitting the IRS to review the extent to which the Hacienda is complying with the requirements of this paragraph; and

(c) informing in writing all Hacienda Representatives and other persons to or by whom disclosure or inspection of Federal returns or Federal return information is authorized of the criminal penalties and civil liability provided by sections 7213 and 7431 of the Code for a disclosure of such returns and return information which is unauthorized by the Code.

4.2 As an express condition for the inspection and disclosure of Possession returns and Possession return information, the IRS agrees to comply with the safeguards and requirements prescribed by section 6103(p)(4) of the Code and any implementation of such safeguards and requirements as may be provided by regulations and published procedures.

4.3 Processing of Federal returns and Federal return information received by the Hacienda from the IRS in the form of microfilms, photoimpressions, magnetic media or other format (including reformatting or reproduction, or conversion to magnetic media, punch cards, or hard copy printout) and transmission and storage of such Federal returns or Federal return information by or on behalf of the Hacienda may be performed by Hacienda owned and/or operated computer facilities, facilities shared by the Hacienda with other Possession agencies, or by any other person described in section 6103(n) of the Code. In those cases where such facilities used by the Hacienda are shared with other Possession agencies or operated by any other person described in section 6103(n) of the Code, the Hacienda will insure the confidentiality of the Federal returns and Federal return information provided to such shared facility or person. As part of this responsibility, the terms of any contract or agreement between the Hacienda and a shared computer facility or other person to whom Federal returns or Federal return information is or may be disclosed for a purpose described in this subsection, will provide, or will be amended to provide, that such person, and officers and employees of the person, will comply with the applicable safeguard conditions contained in regulations, published rules and procedures, or written communications.

4.4 Because some taxpayers may be unaware that Hacienda tax officials are authorized under Federal law to obtain Federal returns and Federal return information for Possession tax administration purposes, the Hacienda will publicize, in a manner satisfactory to the IRS, that such returns or return information were obtained pursuant to specific authority granted by the Code. Similar publicity will be provided by the IRS for Possession tax information furnished to the IRS pursuant to Possession law.

SECTION 5. Limitations

5.1 Pursuant to the provisions of section 6103(p)(2) of the Code, and of Possession law, if any, charges for furnishing returns and return information shall be governed by Article 5, paragraph 3 of the Agreement.

5.2 Under no circumstances will the Hacienda permit any Federal return or Federal return information to be inspected by, or disclosed to an individual who is the chief executive officer of the Possession or any person other than one described in section 2 of this Appendix.

5.3 Notwithstanding any other provision of this Appendix, the IRS will not disclose or make known in any manner whatever to any person other than one described in Section 2 of this Appendix—

(a) any original, copy, or abstract of any return, payment, or registration made pursuant to chapter 35 of the Code (relating to taxes on wagering);

(b) any record required for making any such return, payment, or registration made or required pursuant to chapter 35 which the IRS is permitted by the taxpayer to examine or which is produced pursuant to section 7602 of the Code (relating to the examination of books and witnesses); or

(c) any information obtained by the exploitation of any such return, payment, registration, or record made or required pursuant to chapter 35.

5.4 Notwithstanding any other provision of this Agreement or Appendix, the Internal Revenue Service will disclose or make known in any manner to any person described in section 2 of this Appendix taxpayer information which was obtained pursuant to a tax convention or exchange of information agreement between the United States and a foreign government only if such disclosure is authorized by both the relevant convention or agreement and the Code.

SECTION 6. Officials to Contact for Obtaining Information

6.1 Requests by the Hacienda for Federal returns and Federal return information should be made to the officials named below:

(a) Requests by the Hacienda for Federal return information in magnetic media should be made to the Assistant Commissioner (International), Attn: Disclosure Officer, who will be responsible for coordinating the requests with the IRS National Office;

(b) Requests for physical inspection or copying of Federal returns, or requests for audit abstracts and reports pertaining to such returns, showing addresses within the possession should be made to the Director, Internal Revenue Service Center, Philadelphia, PA, Attn: Disclosure Officer, who will be responsible for making the proper arrangements for inspection or copying; and

(c) Requests by the head of the Hacienda for Federal returns of taxpayers or Federal return information relating to taxpayers showing addresses outside the possession should be made to the Assistant Commissioner (International), Attn: Disclosure Officer.

6.2 Requests by authorized officers and employees of the IRS for inspection or copying of Possession returns and Possession return information should be made to the Assistant Secretary for Internal Revenue and Collections.

Subpart B.—Legislation and Related Committee Reports

Public Law 101-73
101st Congress H.R. 1278[1]
August 9, 1989

An Act to reform, recapitalize, and consolidate the Federal deposit in-

[1]This publication of the law is restricted to excerpts involving tax matters.

surance system, to enhance the regulatory and enforcement powers of Federal financial institutions regulatory agencies, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled.

SECTION 1. SHORT TITLE

This Act may be cited as the "Financial Institutions Reform, Recovery, and Enforcement Act of 1989".

* * * * *

TITLE XIV—TAX PROVISIONS

SEC. 1401. EARLY TERMINATION OF SPECIAL REORGANIZATION RULES FOR FINANCIAL INSTITUTIONS

(a) GENERAL RULE.—

(1) REORGANIZATIONS.—Subparagraph (D) of section 368(a)(3) of the Internal Revenue Code of 1986 (as amended by section 4012 of the Technical and Miscellaneous Revenue Act of 1988) is amended to read as follows:

"(D) AGENCY RECEIVERSHIP PROCEEDINGS WHICH INVOLVE FINANCIAL INSTITUTIONS.—For purposes of subparagraphs (A) and (B), in the case of a receivership, foreclosure, or similar proceeding before a Federal or State agency involving a financial institution referred to in section 581 or 591, the agency shall be treated as a court."

(2) NET OPERATING LOSS RULES.—The last sentence of section 382(l)(5)(F) of such Code (as so amended) is amended by striking "after December 31, 1989" and inserting "on or after May 10, 1989".

(3) FINANCIAL ASSISTANCE.—

(A) Section 597 of such Code (as so amended) is amended to read as follows:

"SEC. 597. TREATMENT OF TRANSACTIONS IN WHICH FEDERAL FINANCIAL ASSISTANCE PROVIDED.

"(a) GENERAL RULE.—The treatment for purposes of this chapter of any transaction in which Federal financial assistance is provided with respect to a bank or domestic building and loan association shall be determined under regulations prescribed by the Secretary.

"(b) PRINCIPLES USED IN PRESCRIBING REGULATIONS.—

"(1) TREATMENT OF TAXABLE ASSET ACQUISITIONS.—In the case of any acquisition of assets to which section 381(a) does not apply, the regulations prescribed under subsection (a) shall—

"(A) provide that Federal financial assistance shall be properly taken into account by the institution from which the assets were acquired, and

"(B) provide the proper method of allocating basis among the assets so acquired (including rights to receive Federal financial assistance).

"(2) OTHER TRANSACTIONS.—In the case of any transaction not described in paragraph (1), the regulations prescribed under subsection (a) shall provide for the proper treatment of Federal financial assistance and appropriate adjustments to basis or other tax attributes to reflect such treatment.

"(3) DENIAL OF DOUBLE BENEFIT.—No regulations prescribed under this section shall permit the utilization of any deduction (or other tax benefit) if such amount was in effect reimbursed by nontaxable Federal financial assistance.

"(c) FEDERAL FINANCIAL ASSISTANCE.—The purposes of this section, the term 'Federal financial assistance' means—

"(1) any money or other property provided with respect to a domestic building and loan association by the Federal Savings and Loan Insurance Corporation or the Resolution Trust Corporation pursuant to section 406(f) of the National Housing Act or section 21A of the Federal Home Loan Bank Act (or under any other similar provision of law), and

"(2) any money or other property provided with respect to a bank or domestic building and loan association by the Federal Deposit Insurance Corporation pursuant to section 11(f) or 13(c) of the Federal Deposit Insurance Act (or under any other similar provision of law), regardless of whether any note or other instrument is issued in exchange therefor.

"(d) DOMESTIC BUILDING AND LOAN ASSOCIATION.—For purposes of this section, the term 'domestic building and loan association' has the meaning given such term by section 7701(a)(19) without regard to subparagraph (C) thereof."

(B) Subparagraph (B) of section 904(c)(2) of the Tax Reform Act of 1986 is hereby repealed.

(C) The table of sections for part II of subchapter H of chapter 1 of such Code is amended by striking the item relating to section 597 and inserting the following:

"Sec. 597. Treatment of transactions in which Federal financial assistance provided."

(b) TECHNICAL AMENDMENTS.—

(1) Section 904 of the Tax Reform Act of 1986 (other than subsection (c)(2)(B) thereof) is hereby repealed and the Internal Revenue Code of 1986 shall be applied as if the amendments made by such section had not been enacted.

(2) The last sentence of paragraph (3) of section 4012(c) of the Technical and Miscellaneous Revenue Act of 1988 is amended to read as follows: "In the case of any bank or any institution treated as a domestic building and loan association for purposes of section 597 of the 1986 Code by reason of the amendment made by subsection (b)(2)(B), the amendments made by this subsection shall also apply to any transfer before January 1, 1989, to which the amendments made by subsection (b)(2) apply."

(3) The last sentence of section 593(e)(1) of such Code is amended to read as follows: "This paragraph shall not apply to any transaction to which section 381 applies, or to any distribution to the Federal Savings and Loan Insurance Corporation (or any successor thereof) or the Federal Deposit Insurance Corporation in redemption of an interest in an association, if such interest was originally received by any such entity in exchange for assistance provided under a provision of law referred to in section 597(c).".

(c) EFFECTIVE DATES.—

(1) SUBSECTION (a)(1).—The amendment made by subsection (a)(1) shall apply to acquisitions on or after May 10, 1989.

(2) SUBSECTION (a)(2).—The amendment made by subsection (a)(2) shall apply to acquisitions on or after May 10, 1989.

(3) SUBSECTION (a)(3).—

(A) IN GENERAL.—The amendments made by subsection (a)(3) shall apply to any amount received or accrued by the financial institution on or after May 10, 1989, except that such amendments shall not apply to transfers on or after such date pursuant to an acquisition to which the amendment made by subsection (a)(1) does not apply.

(B) INTERIM RULE.—In the case of any payment pursuant to a transaction on or after May 10, 1989, and before the date on which the Secretary of the Treasury (or his delegate) takes action in exercise of his regulatory authority under section 597 of the Internal Revenue Code of 1986 (as amended by subsection (a)(3)), the taxpayer may rely on the legislative history for the amendments made by subsection (a)(3) in determining the proper treatment of such payment.

(4) SUBSECTION (b)(1).—The provisions of subsection (b)(1) shall take effect on the date of the enactment of the Tax Reform Act of 1986.

(5) SUBSECTION (b)(2).—The amendment made by subsection (b)(2) shall take effect on the date of the enactment of the Technical and Miscellaneous Revenue Act of 1988.

(6) SUBSECTION (b)(3).—The amendment made by subsection (b)(3) shall take effect on the date of the enactment of this Act.

(7) CLARIFICATION OF PRIOR LAW.—Any reference to the Federal Savings and Loan Insurance Corporation in section 597 of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of this Act) shall be treated as including a reference to the Resolution Trust Corporation and the FSLIC Resolution Fund.

SEC. 1402. TAX EXEMPTION FOR RESOLUTION TRUST CORPORATION AND RESOLUTION FUNDING CORPORATION.

(a) GENERAL RULE.—Subsection (l) of section 501 of the Internal Revenue Code of 1986 (relating to government corporations exempt under subsection (c)(1)) is amended to read as follows:

"(l) GOVERNMENT CORPORATIONS EXEMPT UNDER SUBSECTION (c)(1).—For purposes of subsection (c)(1), the following organizations are described in this subsection:

"(1) The Central Liquidity Facility established under title III of the Federal Credit Union Act (12 U.S.C. 1795 et seq.).

"(2) The Resolution Trust Corporation established under section 21A of the Federal Home Loan Bank Act.

"(3) The Resolution Funding Corporation established under section 21B of the Federal Home Loan Bank Act."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 1403. ANNUAL REPORTS ON TRANSACTIONS IN WHICH FEDERAL FINANCIAL ASSISTANCE PROVIDED.

(a) IN GENERAL.—The Secretary of the Treasury or his delegate shall submit to the Senate and to the Committee on Ways and Means of the House of Representatives annual reports on—

(1)(A) the transactions which occur during the year for which the report is made and with respect to which Federal financial assistance is provided;

(B) the aggregate amount of Federal financial assistance provided with respect to such transactions; and

(C) any tax benefits available by reason of such transactions; and

(2) the aggregate amount of Federal financial assistance provided during such year, and the aggregate tax benefits utilized during such year, which are attributable to such transactions in prior years.

(b) DEFINITION.—For purposes of this section, the term "Federal financial assistance" means any assistance to which section 597 of the Internal Revenue Code of 1986 applies.

SEC. 1404. STUDIES OF RELATIONSHIP BETWEEN PUBLIC DEBT AND ACTIVITIES OF GOVERNMENT-SPONSORED ENTERPRISES.

(a) IN GENERAL.—In order to better manage the bonded indebtedness of the United States, the Secretary shall conduct 2 annual studies to assess the financial safety and soundness of the activities of all Government-sponsored enterprises and the impact of their operations on Federal borrowing.

(b) ACCESS TO RELEVANT INFORMATION.—

(1) INFORMATION FROM GSE'S.—Each Government-sponsored enterprise shall provide full and prompt access to the Secretary to its books and records, and shall promptly provide any other information requested by the Secretary.

(2) INFORMATION FROM SUPERVISORY AGENCIES.—In conducting the studies under this section, the Secretary may request information from, or the assistance of, any Federal department or agency authorized by law to supervise the activities of any Government-sponsored enterprise.

(3) CONFIDENTIALITY OF INFORMATION.—

(A) IN GENERAL.—The Secretary shall determine and maintain the confidentiality of any book, record, or information made available under this subsection in a manner generally consistent with the level of confidentiality established for the material by the Government-sponsored enterprise involved.

(B) EXEMPTION FROM PUBLIC DISCLOSURE REQUIREMENTS.—The Department of the Treasury shall be exempt from section 552 of title 5, United States Code, with respect to any book, record, or information made available under this subsection and determined by the Secretary to be confidential under subparagraph (A).

(C) PENALTY FOR UNAUTHORIZED DISCLOSURE.—Any officer or employee of the Department of the Treasury shall be subject to the penalties set forth in section 1906 of title 18, United States Code, if—

(i) by virtue of his employment or official position, he has possession of or access to any book, record, or information made available under this subsection and determined by the Secretary to be confidential under subparagraph (A); and

(ii) he discloses the material in any manner other than—

(I) to an officer or employee of the Department of

the Treasury; or

(II) pursuant to the exceptions set forth in such section 1906.

(c) ASSESSMENT OF RISK.—In assessing the financial safety and soundness of the activities of Government-sponsored enterprises, and the impact of their activities on Federal borrowing, the Secretary shall quantify the risks associated with each Government-sponsored enterprise. In quantifying such risks, the Secretary shall determine the volume and type of securities outstanding which are issued or guaranteed by each Government-sponsored enterprise, and the degree of risk involved in the operations of each Government-sponsored enterprise due to factors such as credit risk, interest rate risk, management and operations risk, and business risk. The Secretary shall also report on the quality and timeliness of information currently available to the public and the Federal Government concerning the extent and nature of the activities of Government-sponsored enterprises and the financial risk associated with such activities.

(d) REPORTS TO CONGRESS.—The Secretary shall submit to the Congress—

(1) by May 15, 1990, a report setting forth the results of the 1st annual study conducted under this section; and

(2) by May 15, 1991, a report setting forth the results of the 2nd annual study conducted under this section:

(e) DEFINITIONS.—For purposes of this section:

(1) GOVERNMENT-SPONSORED ENTERPRISE.—The term "Government-sponsored enterprise" means—

(A) the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Home Loan Bank System, the Farm Credit Banks, the Banks for Cooperatives, the Federal Agricultural Mortgage Corporation, the Student Loan Marketing Association, the College Construction Loan Insurance Association, and any of their affiliated or member institutions; and

(B) any other Government-sponsored enterprise, as designated by the Secretary.

(2) SECRETARY.—The term "Secretary" means the Secretary of the Treasury or his delegate.

Approved August 9, 1989.

Public Law 101-140
101st Congress H.J. Res. 280[1]
November 9, 1989

Joint Resolution
Increasing the statutory limit on the public debt.

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That subsection (b) of section 3101 of title 31, United States Code, is amended by striking out the dollar limitation contained in such subsection, and inserting in lieu thereof "$3,122,700,000,000".

TITLE II—REPEAL OF SECTION 89 NONDISCRIMINATION RULES

SEC. 201. AMENDMENT OF 1986 CODE.

Whenever in this title an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

SEC. 202. REPEAL OF SECTION 89.

(a) IN GENERAL.—Section 89 (relating to benefits provided under certain discriminatory employee benefit plans) is hereby repealed.

(b) CLERICAL AMENDMENT.—The table of sections for part II of subchapter B of chapter 1 is amended by striking the item relating to section 89.

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in section 1151 of the Tax Reform Act of 1986.

SEC. 203. REINSTATEMENT OF PRE-1986 ACT NONDISCRIMINATION RULES.

(a) IN GENERAL.—

(1) Each provision of law amended by subsection (b), (c), (d)(1), or (g) of section 1151 of the Tax Reform Act of 1986 is amended to read as if the amendments made by such subsection had not been enacted.

(2) Each provision of law amended by paragraph (22), (27), or (31) of section 1011B(a) of the Technical and Miscellaneous Revenue Act of 1988 is amended to read as if the amendments made by such paragraph had not been enacted.

(3) Subparagraph (A) of section 125(g)(3) (as in effect on the day before the date of enactment of the Tax Reform Act of 1986) is amended by striking "subparagraph (B) of section 410(b)(1)" and inserting "section 410(b)(2)(A)(i)".

(4) Section 162(1)(2) is amended by striking subparagraph (B) and redesignating subparagraph (C) as subparagraph (B).

(5) Subparagraph (C) of section 401(a)(9) is amended—

(A) by striking "(as defined in section 89(i)(4))", and

(B) by adding at the end the following: "For purposes of this subparagraph, the term 'church plan' means a plan maintained by a church for church employees, and the term 'church' means any church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)-(3)(B))."

(6)(A) Subparagraph (C) of section 414(n)(3) is amended by striking "89,".

(B) Paragraph (1) of section 414(r) is amended by striking "sections 89 and" inserting "section".

(C) Paragraph (2) of section 414(t) is amended by striking "89,".

(7) Sections 3021(c) and 6070 of the Technical and Miscellaneous Revenue Act of 1988 are hereby repealed.

(b) EXCEPTIONS.—

(1)(A) Paragraph (7) of section 79(d) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) is amended to read as follows:

"(7) EXEMPTION FOR CHURCH PLANS.—

"(A) IN GENERAL.—This subsection shall not apply to a church plan maintained for church employees.

"(B) DEFINITIONS.—For purposes of subparagraph (A), the

[1] This publication of the law is restricted to excerpts involving tax matters.

terms 'church plan' and 'church employee' have the meaning given such terms by paragraphs (1) and (3)(B) of section 414(e), respectively, except that—

"(i) section 414(e) shall be applied by substituting section 501(c)(3)' for 'section 501' each place it appears, and

"(ii) the term 'church employee' shall not include an employee of—

"(I) An organization described in section 170(b)(1)-(A)(ii) above the secondary school level (other than a school for religious training),

"(II) an organization described in section 170(b)(1)-(A)(iii), and

"(III) an organization described in section 501(c)(3), the basis of the exemption for which is substantially similar to the basis for exemption of an organization described in subclause (II)."

(2) Paragraph (2) of section 125(d) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) is amended to read as follows:

"(2) DEFERRED COMPENSATION PLANS EXCLUDED.—

"(A) IN GENERAL.—The term 'cafeteria plan' does not include any plan which provides for deferred compensation.

"(B) EXCEPTION FOR CASH AND DEFERRED ARRANGEMENTS.—Subparagraph (A) shall not apply to a profit-sharing or stock bonus plan or rural cooperative plan (within the meaning of section 401(k)(7)) which includes a qualified cash or deferred arrangement (as defined in section 401(k)(2)) to the extent of amounts which a covered employee may elect to have the employer pay as contributions to a trust under such plan on behalf of the employee.

"(C) EXCEPTION FOR CERTAIN PLANS MAINTAINED BY EDUCATIONAL INSTITUTIONS.—Subparagraph (A) shall not apply to a plan maintained by an educational organization described in section 170(b)(1)(A)(ii) to the extent of amounts which a covered employee may elect to have the employer pay as contributions for post-retirement group life insurance if—

"(i) all contributions for such insurance must be made before retirement, and

"(ii) such life insurance does not have a cash surrender value at any time.

For purpose of section 79, any life insurance described in the preceding sentence shall be treated as group-term life insurance."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in section 1151 of the Tax Reform Act of 1986.

SEC. 204. OTHER PROVISIONS RELATING TO NONTAXABLE BENEFITS

(a) DEPENDENT CARE ASSISTANCE.—

(1) IN GENERAL.—Paragraph (1) of section 129(d) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) is amended by adding at the end thereof the following new sentence: "If any plan would qualify as a dependent care assistance program but for a failure to meet the requirements of this subsection, then, notwithstanding such failure, such plan shall be treated as a dependent care assistance program in the case of employees who are not highly compensated employees."

(2) EXCLUDED EMPLOYEES.—

(A) Section 129(d) is amended by adding at the end thereof the following new paragraph:

"(9) EXCLUDED EMPLOYEES.—For purposes of paragraphs (3) and (8), there shall be excluded from consideration—

"(A) subject to rules similar to the rules of section 410(b)(4), employees who have not attained the age of 21 and completed 1 year of service (as defined in section 410(a)(3)), and

"(B) employees not included in a dependent care assistance program who are included in a unit of employees covered by an agreement which the Secretary finds to be a collective bargaining agreement between employee representatives and 1 or more employees, if there is evidence that dependent care benefits were the subject of good faith bargaining between such employee representatives and such employer or employers."

(B) Section 129(d)(3) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) is amended by striking the last sentence.

(3) DELAY IN APPLICATION OF BENEFITS TEST.—

(A) Paragraph (7) of section 129(d) (as in effect after the amendment made by paragraph (14) of section 1011B(a) of the Technical and Miscellaneous Revenue Act of 1988) is redesignated as paragraph (8).

(B) Paragraph (1) of section 129(d) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) is amended by striking "paragraphs (2) through (7)" and inserting "paragraphs (2) through (8)".

(C) Section 129(e)(6) is amended by striking "(7)" and inserting "(8)".

(D) Section 129(d)(8) (as redesignated by subparagraph (A)) shall apply to plan years beginning after December 31, 1989.

(b) LINE OF BUSINESS TEST.—

(1) APPLICATION OF LINE OF BUSINESS TEST FOR PERIOD BEFORE GUIDELINES ISSUED.—In the case of any plan year beginning on or before the date the Secretary of the Treasury or his delegate issues guidelines and begins issuing determinations under section 414(r)(2)(C) of the Internal Revenue Code of 1986, an employer shall be treated as operating separate lines of business if the employer reasonably determines that it meets the requirements of section 414(r) (other than paragraph (2)(C) thereof) of such Code.

(2) DEPENDENT CARE.—Paragraph (1) of section 414(r) is amended by striking "section 410(b)" and inserting "sections 129(d)(8) and 410(b)".

(c) GROUP-TERM LIFE INSURANCE.—Paragraph (7) of section 505(b) (relating to $200,000 compensation limit) is amended by adding at the end thereof the following new

sentence: "This paragraph shall not apply in determining whether the requirements of section 79(d) are met."

(d) EFFECTIVE DATES.—

(1) The amendments made by subsections (a)(1), (a)(2), and (b)(2) shall apply to years beginning after December 31, 1988.

(2) The amendments made by subsection (a)(3) shall apply to plan years beginning after December 31, 1989.

(3) The provisions of subsection (b)(1) shall apply to years beginning after December 31, 1986.

(4) The amendment made by subsection (c) shall take effect as if included in the amendment made by section 1011B(a)(32) of the Technical and Miscellaneous Revenue Act of 1988.

* * * * *

Public Law 101-194
101st Congress H.R. 3660[1]
November 30, 1989

An Act to amend the Rules of the House of Representatives and the Ethics in Government Act of 1978 to provide for Government-wide ethics reform, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Ethics Reform Act of 1989".

* * * * *

TITLE V—OTHER ETHICS REFORMS

SEC. 501. REFERRAL OF ETHICS VIOLATIONS BY THE SENATE ETHICS COMMITTEE TO THE GENERAL ACCOUNTING OFFICE FOR INVESTIGATION.

If the Committee on Ethics of the Senate determines that there is a reasonable basis to believe that a Member, officer, or employee of the Senate may have committed an ethics violation, the committee may request the Office of Special Investigations of the General Accounting Office to conduct factfinding and an investigation into the matter. The Office of Special Investigations shall promptly investigate the matter as directed by the committee.

SEC. 502. NONRECOGNITION FOR CERTAIN SALES TO COMPLY WITH CONFLICT-OF-INTEREST REQUIREMENTS.

(a) GENERAL RULE.—Part III of subchapter O of chapter 1 of the Internal Revenue Code of 1986 (relating to common nontaxable exchanges) is amended by adding at the end thereof the following new section:

"SEC. 1043. SALE OF PROPERTY TO COMPLY WITH CONFLICT-OF- INTEREST REQUIREMENTS.

"(a) NONRECOGNITION OF GAIN.—If an eligible person sells any property pursuant to a certificate of divestiture, at the election of the taxpayer, gain from such sale shall be recognized only to the extent that the amount realized on such sale exceeds the cost (reduced by any basis adjustment under subsection (c) attributable to a prior sale) of any permitted property purchased by the taxpayer during the 60-day period beginning on the date of such sale.

"(b) DEFINITIONS.—For purposes of this section—

"(1) ELIGIBLE PERSON.—The term 'eligible person' means—

"(A) an officer or employee of the executive branch of the Federal Government, but does not mean a special Government employee as defined in section 202 of title 18, United States Code, and

"(B) any spouse or minor or dependent child whose ownership of any property is attributable under any statute, regulation, rule, or executive order referred to in paragraph (2) to a person referred to in subparagraph (A).

"(2) CERTIFICATE OF DIVESTITURE.—The term 'certificate of divestiture' means any written determination—

"(A) that states that divestiture of specific property is reasonably necessary to comply with any Federal conflict of interest statute, regulation, rule, or executive order (including section 208 of title 18, United States Code), or requested by a congressional committee as a condition of confirmation,

"(B) that has been issued by the President or the Director of the Office of Government Ethics, and

"(C) that identifies the specific property to be divested.

"(3) PERMITTED PROPERTY. The term 'permitted property' means any obligation of the United States or any diversified investment fund approved by regulations issued by the Office of Government Ethics.

"(4) PURCHASE.—The taxpayer shall be considered to have purchased any permitted property if, but for subsection (c), the unadjusted basis of such property would be its cost within the meaning of section 1012.

"(c) BASIS ADJUSTMENTS.—If gain from the sale of any property is not recognized by reason of subsection (a), such gain shall be applied to reduce (in the order acquired) the basis for determining gain or loss of any permitted property which is purchased by the taxpayer during the 60-day period described in subsection (a).".

(b) TECHNICAL AMENDMENTS.—

(1) Section 1223 of such Code (relating to holding period of property) is amended by redesignating paragraph (14) as paragraph (15) and by inserting after paragraph (13) the following new paragraph:

"(14) In determining the period for which the taxpayer has held property the acquisition of which resulted under section 1043 in the nonrecognition of any part of the gain realized on the sale of other property there shall be included the period for which such other property, had been held as of the date of such sale.".

(2) Subsection (a) of section 1016 of such Code (relating to adjustments to basis) is amended by striking "and" at the end of paragraph (23), by striking the period at the end of paragraph (24) and inserting ",and", and by adding at the end thereof the following new paragraph:

"(25) in the case of property the acquisition of which resulted under section 1043 in the nonrecognition of any part of the gain realized on

[1] This publication of the law is restricted to excerpts involving tax matters.

the sale of other property, to the extent provided in section 1043(c).".

(3) The table of sections for part III of subchapter O of chapter 1 of such Code is amended by adding at the end thereof the following new item:

"Sec. 1043. Sale of property to comply with conflict-of- interest requirements.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to sales after the date of the enactment of this Act.

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Public Law 101-239
101st Congress H.R. 3299.[1]
Dec. 19, 1989

An Act to provide for reconciliation pursuant to section 5 of the concurrent resolution on the budget for the fiscal year 1990.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Omnibus Budget Reconciliation Act of 1989".

SEC. 2. TABLE OF CONTENTS.

Title I—Agriculture and related programs.
Title II—Student loan and pension fiduciary amendments.
Title III—Regulatory agency fees.
Title IV—Civil service and postal service programs.
Title V—Veterans programs.
Title VI—Medicare, Medicaid, maternal and child health, and other health provisions.
Title VII—Revenue provisions.
Title VIII—Human resource and income security provisions.
Title IX—Offshore oil pollution compensation fund.
Title X—Miscellaneous and technical Social Security Act amendments.
Title XI—Miscellaneous.

* * * * *

SEC. 6202. MEDICARE AS SECONDARY PAYER.

(a) IDENTIFICATION OF MEDICARE SECONDARY PAYER SITUATIONS.—

(1) DISCLOSURE OF CERTAIN TAXPAYER IDENTITY INFORMATION FOR VERIFICATION OF EMPLOYMENT STATUS OF MEDICARE BENEFICIARY AND SPOUSE OF MEDICARE BENEFICIARY.—

(A) IN GENERAL.—Subsection (1) of section 6103 of the Internal Revenue Code of 1986 (relating to disclosure of returns and return information for purposes other than tax administration) is amended by adding at the end thereof the following new paragraph:

"(12) DISCLOSURE OF CERTAIN TAXPAYER IDENTITY INFORMATION FOR VERIFICATION OF EMPLOYMENT STATUS OF MEDICARE BENEFICIARY AND SPOUSE OF MEDICARE BENEFICIARY.—

"(A) RETURN INFORMATION FROM INTERNAL REVENUE SERVICE.—The Secretary shall, upon written request from the Commissioner of Social Security, disclose to the Commissioner available filing status and taxpayer identity information from the individual master files of the Internal Revenue Service relating to whether any Medicare beneficiary identified by the Commissioner was a married individual (as defined in section 7703) for any specified year after 1986, and, if so, the name of the spouse of such individual and such spouse's TIN.

"(B) RETURN INFORMATION FROM SOCIAL SECURITY ADMINISTRATION.—The Commissioner of Social Security shall, upon written request from the Administrator of the Health Care Financing Administration, disclose to the Administrator the following information:

"(i) The name and TIN of each Medicare beneficiary who is identified as having received wages (as defined in section 3401(a)) from a qualified employer in a previous year.

"(ii) For each Medicare beneficiary who was identified as married under subparagraph (A) and whose spouse is identified as having received wages from a qualified employer in a previous year—

"(I) the name and TIN of the Medicare beneficiary, and

"(II) the name and TIN of the spouse.

"(iii) With respect to each such qualified employer, the name, address, and TIN of the employer and the number of individuals with respect to whom written statements were furnished under section 6051 by the employer with respect to such previous year.

"(C) DISCLOSURE BY HEALTH CARE FINANCING ADMINISTRATION.—With respect to the information disclosed under subparagraph (B), the Administrator of Health Care Financing Administration may disclose—

"(i) to the qualified employer referred to in such subparagraph the name and TIN of each individual identified under such subparagraph as having received wages from the employer (hereinafter in this subparagraph referred to as the 'employee') for purposes of determining during what period such employee or the employee's spouse may be (or have been) covered under a group health plan of the employer and what benefits are or were covered under the plan (including the name, address, and identifying number of the plan),

"(ii) to any group health plan which provides or provided coverage to such an employee or spouse, the name of such employee and the employee's spouse (if the spouse is a Medicare beneficiary) and the name and address of the employer, and, for the purpose of presenting a claim to the plan—

"(I) the TIN of such employee if benefits were paid under title XVIII of the Social Security Act with respect to the employee during a period in which the plan was a primary plan (as defined in section 1862(b)(2)(A) of the Social Security Act), and

"(II) the TIN of such spouse if benefits were paid under such title with respect to the spouse during such period, and

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[1] This publication of the law is restricted to excerpts involving tax matters.

"(iii) to any agent of such Administrator the information referred to in subparagraph (B) for purposes of carrying out clauses (i) and (ii) on behalf of such Administrator.

"(D) SPECIAL RULES.—

"(i) RESTRICTIONS ON DISCLOSURE.—Information may be disclosed under this paragraph only for purposes of, and to the extent necessary in, determining the extent to which any Medicare beneficiary is covered under any group health plan.

"(ii) TIMELY RESPONSE TO REQUESTS.—Any request made under subparagraph (A) or (B) shall be complied with as soon as possible but in no event later than 120 days after the date the request was made.

"(E) DEFINITIONS.—For purposes of this paragraph—

"(i) MEDICARE BENEFICIARY.—The term 'Medicare beneficiary' means an individual entitled to benefits under part A, or enrolled under part B, of title XVIII of the Social Security Act, but does not include such an individual enrolled in part A under section 1818.

"(ii) GROUP HEALTH PLAN.—The term 'group health plan' means—

"(I) any group health plan (as defined in section 5000(b)(1)), and

"(II) any large group health plan (as defined in section 5000(b)(2)).

"(iii) QUALIFIED EMPLOYER.—The term 'qualified employer' means, for a calendar year, an employer which has furnished written statements under section 6051 with respect to at least 20 individuals for wages paid in the year.

"(F) TERMINATION.—Subparagraphs (A) and (B) shall not apply to—

"(i) any request made after September 30, 1991, and

("(ii) any request made before such date for information relating to—

"(I) 1990 or thereafter in the case of subparagraph (A), or

"(II) 1991 or thereafter in the case of subparagraph (B)."

(B) SAFEGUARDS.—

(i) Paragraph (3) of section 6103(a) of such Code is amended by inserting "(1)(12)," after "(e)(1)(D)(iii),".

(ii) Subparagraph (A) of section 6103(p)(3) of such Code is amended by striking "or (11)" and inserting "(11), or (12)".

(iii) Paragraph (4) of section 6103(p) of such Code is amended in the material preceding subparagraph (A) by striking "or (9) shall" and inserting "(9), or (12) shall".

(iv) Clause (ii) of section 6103(p)(4)(F) of such Code is amended by striking "or (11)" and inserting "(11), or (12)".

(v) The next to the last sentence of paragraph (4) of section 6103(p) of such Code is amended by inserting "or which receives any information under subsection (1)(12)(B) and which discloses any such information to any agent" before ", this paragraph".

(C) PENALTY.—Paragraph (2) of section 7213(a) of such Code is amended by striking "or (10)" and inserting "(10), or (12)".

(D) EFFECTIVE DATE.—The amendments made by this paragraph shall take effect on the date of the enactment of this Act.

(2) RESPONSIBILITIES OF HCFA.—

(A) In general.—Section 1862(b) of the Social Security Act (42 U.S.C. 1395y(b)), as amended by subsection (b)(1) of this section, is amended by inserting after paragraph (4) the following new paragraph:

"(5) IDENTIFICATION OF SECONDARY PAYER SITUATIONS.—

"(A) REQUESTING MATCHING INFORMATION.—

"(i) COMMISSIONER OF SOCIAL SECURITY.—The Commissioner of Social Security shall, not less often than annually, transmit to the Secretary of the Treasury a list of the names and TINs of Medicare beneficiaries (as defined in section 6103(1)(12) of the Internal Revenue Code of 1986) and request that the Secretary disclose to the Commissioner the information described in subparagraph (A) of such section.

"(ii) ADMINISTRATOR.—The Administrator of the Health Care Financing Administration shall request, not less often than annually, the Commissioner of the Social Security Administration to disclose to the Administrator the information described in subparagraph (B) of section 6103(1)(12) of the Internal Revenue Code of 1986.

"(B) DISCLOSURE TO FISCAL INTERMEDIARIES AND CARRIERS.—In addition to any other information provided under this title to fiscal intermediaries and carriers, the Administrator shall disclose to such intermediaries and carriers (or to such a single intermediary or carrier as the Secretary may designate) the information received under subparagraph (A) for the purposes of carrying out this subsection.

"(C) CONTACTING EMPLOYERS.—

"(i) IN GENERAL.—With respect to each individual (in this subparagraph referred to as an 'employee') who was furnished a written statement under section 6051 of the Internal Revenue Code of 1986 by a qualified employer (as defined in section 6103(1)(12)(D)(iii) of such Code), as disclosed under subparagraph (B), the appropriate fiscal intermediary or carrier shall contact the employer in order to determine during what period the employee or employee's spouse may be (or have been) covered under a group health plan of the employer and the nature of the coverage that is or was provided under the plan (including the name, address, and identifying number of the plan).

"(ii) EMPLOYER RESPONSE.—Within 30 days of the date of receipt of the inquiry, the employer shall notify the intermediary or carrier making the inquiry as to the determinations described in clause (i). An employer (other than a Federal or other governmental entity) who willfully

or repeatedly fails to provide timely and accurate notice in accordance with the previous sentence shall be subject to a civil money penalty of not to exceed $1,000 for each individual with respect to which such an inquiry is made. The provisions of section 1128A (other than subsections (a) and (b)) shall apply to a civil money penalty under the previous sentence in the same manner as such provisions apply to a penalty or proceeding under section 1128A(a).

"(iii) SUNSET ON REQUIREMENT.—Clause (ii) shall not apply to inquiries made after September 30, 1991.".

(B) DEADLINE FOR FIRST REQUEST.—The Commissioner of Social Security shall first—

(i) transmit to the Secretary of the Treasury information under paragraph (5)(A)(i) of section 1862(b) of the Social Security Act (as inserted by subparagraph (A)), and

(ii) request from the Secretary disclosure of information described in section 6013(1)-(12)(A) of the Internal Revenue Code of 1986,

by not later than 14 days after the date of the enactment of this Act.

(b) UNIFORM ENFORCEMENT AND COORDINATION OF BENEFITS.—

(1) IN GENERAL.—Section 1862 of the Social Security Act (42 U.S.C. 1395y) is amended—

(A) in the heading, by adding at the end of the following: "and Medicare as secondary payer"; and

(B) by amending subsection (b) to read as follows:

"(b) Medicare as Secondary Payer.—

"(1) REQUIREMENTS OF GROUP HEALTH PLANS.—

"(A) WORKING AGED UNDER GROUP HEALTH PLANS.—

"(i) IN GENERAL.—A group health plan—

"(I) may not take into account, for any item or service furnished to an individual 65 years of age or older at this time the individual is covered under the plan by reason of the current employment of the individual (or the individual's spouse), that the individual is entitled to benefits under this title under section 226(a), and

"(II) shall provide that any employee age 65 or older, and any employee's spouse age 65 or older, shall be entitled to the same benefits under the plan under the same conditions as any employee, and the spouse of such employee, under age 65.

"(ii) EXCLUSION OF GROUP HEALTH PLAN OF A SMALL EMPLOYER.—Clause (i) shall not apply to a group health plan unless the plan is sponsored by or contributed to by an employer that has 20 or more employees for each working day in each of 20 or more calendar weeks in the current calendar year or the preceding calendar year.

"(iii) EXCEPTION FOR SMALL EMPLOYERS IN MULTIEMPLOYER, OR MULTIPLE EMPLOYER GROUP HEALTH PLANS.—Clause (i) also shall not apply with respect to individuals enrolled in a multiemployer or multiple employer group health plan if the coverage of the individuals under the plan is by virtue of employment with an employer that does not have 20 or more employees for each working day in each of 20 or more calendar weeks in the current calendar year or the preceding calendar year; except that the exception provided in this clause shall only apply if the plan elects treatment under this clause.

"(iv) EXCEPTION FOR INDIVIDUALS WITH END STAGE RENAL DISEASE.—Clause (i) shall not apply to an item or service furnished in a month to an individual if for the month the individual is, or would upon application be, entitled to benefits under section 226A.

"(v) GROUP HEALTH PLAN DEFINED.—In this subparagraph, and subparagraph (C), the term 'group health plan' has the meaning given such term in section 5000(b)(1) of the Internal Revenue Code of 1986.

"(B) DISABLED ACTIVE INDIVIDUALS IN LARGE GROUP HEALTH PLANS.—

"(i) IN GENERAL.—A large group health plan (as defined in clause (iv)(II)) may not take into account that an active individual (as defined in clause (iv)(I)) is entitled to benefits under this title under section 226(b).

"(ii) EXCEPTION FOR INDIVIDUALS WITH END STAGE RENAL DISEASE.—Clause (i) shall not apply to an item or service furnished in a month to an individual if for the month the individual is, or would upon application be, entitled to benefits under section 226A.

"(iii) SUNSET.—Clause (i) shall only apply to items and services furnished on or after January 1, 1987, and before January 1, 1992.

"(iv) DEFINITIONS.—In this subparagraph:

"(I) ACTIVE INDIVIDUAL.—The term 'active individual' means an employee (as may be defined in regulations), the employer, self-employed individual (such as the employer), an individual associated with the employer in a business relationship, or a member of the family of any of such persons.

"(II) LARGE GROUP HEALTH PLAN.—The term 'large group health plan' has the meaning given such term in section 5000(b)(2) of the Internal Revenue Code of 1986.

"(C) INDIVIDUALS WITH END STAGE RENAL DISEASE.—A group health plan (as defined in subparagraph (A)(v))—

"(i) may not take into account that an individual is entitled to benefits under this title solely by reason of section 226A during the 12-month period which begins with the earlier of—

"(I) the month in which a regular course of renal dialysis is initiated, or

"(II) in the case of an individual who receives a kidney transplant, the first month in which he would be eligible for benefits under part A (if he has filed an application for such benefits) under the provisions of section 226A(b)(1)(B); and

"(ii) may not differentiate in the benefits it provides between individuals having end stage renal disease and other individuals covered by such plan on the basis of the existence of end stage renal disease, the need for renal dialysis, or in any other manner;

except that clause (ii) shall not prohibit a plan from taking into account that an individual is entitled to benefits under this title solely by reason of section 226A after the end of the 12-month period described in clause (i).

"(2) MEDICARE SECONDARY PAYER.—

"(A) IN GENERAL.—Payment under this title may not be made, except as provided in subparagraph (B), with respect to any item or service to the extent that—

"(i) payment has been made, or can reasonably be expected to be made, with respect to the item or service as required under paragraph (1), or

"(ii) payment has been made or can reasonably be expected to be made promptly (as determined in accordance with regulations) under a workman's compensation law or plan of the United States or a State or under an automobile or liability insurance policy or plan (including a self-insured plan) or under no fault insurance.

In this subsection, the term 'primary plan' means a group health plan or large group health plan, to the extent that clause (i) applies, and a workmen's compensation law or plan, an automobile or liability insurance policy or plan (including a self-insured plan) or no fault insurance, to the extent that clause (ii) applies.

"(B) CONDITIONAL PAYMENT.—

"(i) PRIMARY PLANS.—Any payment under this title with respect to any item or service to which subparagraph (A) applies shall be conditioned on reimbursement to the appropriate Trust Fund established by this title when notice or other information is received that payment for such item or service has been or could be made under such subparagraph.

"(ii) ACTION BY UNITED STATES.—In order to recover payment under this title for such an item or service, the United States may bring an action against any entity which is required or responsible under this subsection to pay with respect to such item or service (or any portion thereof) under a primary plan (and may, in accordance with paragraph (3)(A) collect double damages against that entity), or against any other entity (including any physician or provider) that has received payment from that entity with respect to the item or service, and may join or intervene in any action related to the events that gave rise to the need for the item or service.

"(iii) SUBROGATION RIGHTS.— The United States shall be subrogated (to the extent of payment made under this title for such an item or service) to any right under this subsection of an individual or any other entity to payment with respect to such item or service under a primary plan.

"(iv) WAIVER OF RIGHTS.—The Secretary may waive (in whole or in part) the provisions of this subparagraph in the case of an individual claim if the Secretary determines that the waiver is in the best interests of the program established under this title.

"(3) ENFORCEMENT.—

"(A) PRIVATE CAUSE OF ACTION.—There is established a private cause of action for damages (which shall be in an amount double the amount otherwise provided) in the case of a primary plan which fails to provide for primary payment (or appropriate reimbursement) in accordance with such paragraphs (1) and (2)(A).

"(B) REFERENCE TO EXCISE TAX WITH RESPECT TO NONCONFORMING GROUP HEALTH PLANS.—For provisions imposing an excise tax with respect to nonconforming group health plans, see section 5000 of the Internal Revenue Code of 1986.

"(4) COORDINATION OF BENEFITS.—Where payment for an item or service by a primary plan is less than the amount of the charge for such item or service and is not payment in full, payment may be made under this title (without regard to deductibles and coinsurance under this title) for the remainder of such charge, but—

"(A) payment under this title may not exceed an amount which would be payable under this title for such item or service if paragraph (2)(A) did not apply; and

"(B) payment under this title, when combined with the amount payable under the primary plan, may not exceed—

"(i) in the case of an item or service payment for which is determined under this title on the basis of reasonable cost (or other cost-related basis) or under section 1886, the amount which would be payable under this title on such basis, and

"(ii) in the case of an item or service for which payment is authorized under this title on another basis—

"(I) the amount which would be payable under the primary plan (without regard to deductibles and coinsurance under such plan), or

"(II) the reasonable charge or other amount which would be payable under this title (without regard to deductibles and coinsurance under this title),

whichever is greater."

(2) ENFORCEMENT THROUGH EXCISE TAX.—Section 5000 of the Internal Revenue Code of 1986 is amended—

(A) by striking "LARGE" in the heading;

(B) in subsection (a), by striking "large" each place it appears; and

(C) by amending subsections (b) and (c) to read as follows:

"(b) GROUP HEALTH PLAN AND LARGE GROUP HEALTH PLAN.—For purposes of this section—

"(1) GROUP HEALTH PLAN.—The term 'group health plan' means any plan of, or contributed to by, an employer (including a self-insured plan) to provide health care (directly or otherwise) to the employer's employees, former employees, or the families of such employees or former employees.

"(2) LARGE GROUP HEALTH PLAN.—The term 'large group health plan' means a plan of, or contributed to by, an employer or employee organization (including a self-insured plan) to provide health care (directly or otherwise) to the employees, former employees, the employer, others associated or formerly associated with the employer in a business relationship, or their families, that covers employees of at least one employer that normally employed at least 100 employees on a typical business day during the previous calendar year.

"(c) NONCONFORMING GROUP HEALTH PLAN.—For purposes of this section, the term 'nonconforming group health plan' means a group health plan or large group health plan that at any time during a calendar year does not comply with the requirements of subparagraphs (A) and (C) or subparagraph (B), respectively, of section 1862(b)(1) of the Social Security Act.".

(3) REPEAL OF CERTAIN ALTERNATIVE ENFORCEMENT PROVISIONS.—

(A) DENIAL OF DEDUCTION FOR GROUP HEALTH PLANS.—Subsection (i) of section 162 of such Code (relating to group health plans) is repealed.

(B) CONFORMING AMENDMENT.—Section 4980(B)(g)(2) of such Code is amended by striking "162(i)" and inserting "5000(b)(1)".

(C) AGE DISCRIMINATION IN EMPLOYMENT ACT.—The Age Discrimination in Employment Act of 1967 is amended—

(i) by striking subsection (g) of section 4, and

(ii) in section 12(a), by striking "(except the provisions of section 4(g))".

(4) CLERICAL AND CONFORMING AMENDMENTS.—

(A) Chapter 47 of the Internal Revenue Code of 1986 is amended—

(i) in the heading, by striking "LARGE", and

(ii) in the table of sections, by striking "large".

(B) The item in the table of chapters of subtitle D of such Code relating to chapter 47 is amended by striking "large".

(C) Sections 1837(i) and 1839(b) of the Social Security Act (42 U.S.C. 1395p(i), 1395r(b)) are each amended by striking "1862(b)(3)(A)(iv)" and "1862(b)(4)(B)" each place each appears and inserting "1862(b)(1)(A)(v)" and "1862(b)(1)(B)(iv)", respectively:

(5) EFFECTIVE DATE.—The amendments made by this subsection shall apply to items and services furnished after the date of the enactment of this Act.

(c) SPECIAL ENROLLMENT PERIOD FOR DISABLED EMPLOYEES.—

* * * * *

TITLE VII—REVENUE MEASURES

SEC. 7001. SHORT TITLE; ETC.

(a) SHORT TITLE.—This title may be cited as the "Revenue Reconciliation Act of 1989".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this title an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) TABLE OF CONTENTS.—

TITLE VII—REVENUE MEASURES

Sec. 7001. Short title; etc.

Subtitle A—Extension of Expiring Tax Provisions

Sec. 7101. Employer-provided educational assistance.
Sec. 7102. Employer-provided group legal services.
Sec. 7103. Extension and modification of targeted jobs credit.
Sec. 7104. Extension of qualified mortgage bonds.
Sec. 7105. Extension of qualified small issue bonds.
Sec. 7106. Extension of energy investment credit for solar, geothermal, and ocean thermal property.
Sec. 7107. Extension of special rules for health insurance costs of self-employed individuals.
Sec. 7108. Extension and modification of low-income housing credit.
Sec. 7109. Low-income housing credit exempt from income phase out of $25,000 exemption from passive loss rules.
Sec. 7110. Extension and modification of research credit.
Sec. 7111. Allocation of research and experimental expenditures.

Subtitle B—Corporate Provisions

Sec. 7201. Limitation on use of group losses to offset income of subsidiary paying preferred dividends.
Sec. 7202. Treatment of certain high yield original issue discount obligations.
Sec. 7203. Securities treated as boot under section 351.
Sec. 7204. Provisions related to regulated investment companies.
Sec. 7205. Limitation on threshold requirement under section 382 built-in gain and loss provisions.
Sec. 7206. Distributions- on certain preferred stock treated as extraordinary dividends.
Sec. 7207. Repeal of election to reduce excess loss account recapture by reducing basis of indebtedness.
Sec. 7208. Other provisions relating to treatment of stock and debt; etc.
Sec. 7209. Estimated tax payments required for S corporations.
Sec. 7210. Limitation on deduction for certain interest paid to related person.
Sec. 7211. Limitations on refunds due to net operating loss carrybacks or excess interest allocable to corporate equity reduction transactions.

Subtitle C—Employee Benefit Provisions

PART I—EMPLOYEE STOCK OWNERSHIP PLAN PROVISIONS

Sec. 7301. Limitations on partial exclusion of interest on loans used to acquire employer securities.

Sec. 7302. Limitations on deductions for dividends paid on employer securities.
Sec. 7303. 3-year holding period required before section 1042 sale.
Sec. 7304. Repeal of certain provisions relating to employee stock ownership plans.

PART II—SECTION 401(h) ACCOUNTS

Sec. 7311. Limitation on contributions to section 401(h) accounts.

Subtitle D—Foreign Provisions

Sec. 7401. Taxable year of certain foreign corporations.
Sec. 7402. Limitation on use of deconsolidation to avoid foreign tax credit limitations.
Sec. 7403. Information with respect to certain foreign-owned corporations.
Sec. 7404. Repeal of special treatment of interest on certain foreign loans.

Subtitle E—Excise Tax Provisions

Sec. 7501. 1-year suspension of automatic reduction in aviation-related taxes.
Sec. 7502. Acceleration of deposit requirements for airline ticket tax.
Sec. 7503. Increase in international air passenger departure tax.
Sec. 7504. Ship passengers international departure tax.
Sec. 7505. Oil Spill Liability Trust Fund tax to take effect on January 1, 1990.
Sec. 7506. Excise tax on sale of chemicals which deplete the ozone layer and of products containing such chemicals.
Sec. 7507. Acceleration of deposit requirements for gasoline excise tax.
Sec. 7508. Taxation of bulk cigar imports.

Subtitle F—Miscellaneous Provisions

PART I—LIMITATION ON NONRECOGNITION FOR CERTAIN EXCHANGES

Sec. 7601. Like kind exchanges between related persons.

PART II—MINIMUM TAX PROVISIONS

Sec. 7611. Simplification of adjusted current earnings preference.
Sec. 7612. Other modifications to minimum tax.

PART III—ACCOUNTING PROVISIONS

Sec. 7621. Repeal of completed contract method of accounting for long-term contracts.
Sec. 7622. Changes in treatment of transfers of franchises, trademarks, and trade names.

PART IV—EMPLOYMENT TAX PROVISIONS

Sec. 7631. Treatment of agricultural workers under wage withholding.
Sec. 7632. Acceleration of deposit requirements.

PART V—OTHER PROVISIONS

Sec. 7641. Limitation on section 104 exclusion.
Sec. 7642. Treatment of distributions by partnerships of contributed property.
Sec. 7643. Depreciation treatment of cellular telephones.
Sec. 7644. Elimination of retroactive certification of employees for work incentive job credit.
Sec. 7645. Disallowance of depreciation for certain term interests.
Sec. 7646. Reporting of points on mortgage loans.
Sec. 7647. Treatment of certain investment-oriented life insurance contracts.

PART VI—TAX EXEMPT BOND PROVISIONS

Sec. 7651. Treatment of hedge bonds.
Sec. 7652. Exceptions from arbitrage rebate requirement.

Subtitle G—Revision of Civil Penalties

Sec. 7701. Short title.

PART I—DOCUMENT AND INFORMATION RETURN PENALTIES

Sec. 7711. Uniform penalties for failures to comply with certain information reporting requirements.
Sec. 7712. Information required with respect to certain foreign corporations.
Sec. 7713. Uniform requirements for returns on magnetic media.
Sec. 7714. Study of procedures to prevent mismatching.
Sec. 7715. Study of service bureaus.

PART II—REVISION OF ACCURACY-RELATED PENALTIES

Sec. 7721. Revision of accuracy-related penalties.

PART III—PREPARER, PROMOTER, AND PROTESTER PENALTIES

Sec. 7731. Penalty for instituting proceedings before tax court primarily for delay, etc.
Sec. 7732. Modifications to penalties on return preparers for certain under statements.
Sec. 7733. Modifications to other assessable penalties with respect to return preparers.
Sec. 7734. Modifications to penalty for promoting abusive tax shelters, etc.
Sec. 7735. Modifications to penalties for aiding and abetting understatement of tax liability.
Sec. 7736. Modification to penalty for frivolous income tax return.
Sec. 7737. Authority to counterclaim for balance of penalty in partial refund suits.
Sec. 7738. Repeal of bonding requirement under section 7407.
Sec. 7739. Certain disclosures of information by preparers permitted.

PART IV—FAILURES TO FILE OR PAY

Sec. 7741. Increase in penalty for fraudulent failure to file.
Sec. 7742. Failure to make deposit of taxes.
Sec. 7743. Effect of payment of tax by recipient on certain penalties.

Subtitle H—Technical Corrections

Sec. 7801. Definitions; coordination with other subtitles.

PART I—AMENDMENTS RELATED TO TECHNICAL AND MISCELLANEOUS REVENUE ACT OF 1988

Sec. 7811. Amendments related to title I of the 1988 Act.
Sec. 7812. Amendments related to title II of the 1988 Act.
Sec. 7813. Amendments related to title III of the 1988 Act.
Sec. 7814. Amendments related to title IV of the 1988 Act.
Sec. 7815. Amendments related to title V of the 1988 Act.
Sec. 7816. Amendments related to title VI of the 1988 Act.
Sec. 7817. Effective date.

PART II—AMENDMENTS RELATED TO REVENUE ACT OF 1987

Sec. 7821. Amendments related to subtitle B.
Sec. 7822. Amendments related to subtitle C and following subtitles.

Sec. 7823. Effective date.

PART III—AMENDMENTS RELATED TO TAX REFORM ACT OF 1986

Sec. 7831. Amendment related to Tax Reform Act of 1986.

PART IV—MISCELLANEOUS CHANGES

Sec. 7841. Miscellaneous changes.

PART V—AMENDMENTS RELATED TO PENSION PROVISIONS

Sec. 7851. Definitions.

SUBPART A—AMENDMENTS RELATED TO TAX REFORM ACT OF 1986

Sec. 7861. Amendments related to title XI of the Reform Act.
Sec. 7862. Amendments related to title XVIII of the Reform Act.
Sec. 7863. Effective date.

SUBPART B—AMENDMENTS RELATED TO OMNIBUS BUDGET RECONCILIATION ACT OF 1986

Sec. 7871. Amendments related to Omnibus Budget Reconciliation Act of 1986.

SUBPART C—AMENDMENTS RELATED TO PENSION PROTECTION ACT

Sec. 7881. Amendments related to Pension Protection Act.
Sec. 7882. Effective date.

SUBPART D—ADDITIONAL PENSION PROVISIONS

Sec. 7891. Amendments relating to the Tax Reform Act of 1986.
Sec. 7892. Amendments relating to the Pension Protection Act.
Sec. 7983. Amendments relating to the Single-Employer Pension Plan Amendments Act of 1986.
Sec. 7894. Other amendments to ERISA.

Subtitle A—Extension of Expiring Tax Provisions

SEC. 7101. EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE.

(a) EXTENSION.—

(1) IN GENERAL.—Subsection (d) of section 127 (relating to educational assistance programs) is amended by striking "December 31, 1988" and inserting "September 30, 1990".

(2) SPECIAL RULE.—In the case of any taxable year beginning in 1990, only amounts paid before October 1, 1990, by the employer for educational assistance for the employee shall be taken into account in determining the amount excluded under section 127 of the Internal Revenue Code of 1986 with respect to such employee for such taxable year.

(b) CERTAIN OTHERWISE TAXABLE EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE MAY BE EXCLUDIBLE AS WORKING CONDITION FRINGE—Subsection (h) of section 132 is amended by adding at the end thereof the following new paragraph:

"(9) APPLICATION OF SECTION TO OTHERWISE TAXABLE EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE.—Amounts which would be excludible from gross income under section 127 but for subsection (a)(2) thereof or the last sentence of subsection (c)(1) thereof shall be excluded from gross income under this section if (and only if) such amounts are a working condition fringe."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1988.

SEC. 7102. EMPLOYER-PROVIDED GROUP LEGAL SERVICES.

(a) EXTENSION.—

(1) IN GENERAL.—Subsection (e) of section 120 (relating to group legal service plans) is amended by striking "ending after December 31, 1988" and inserting "beginning after September 30, 1990".

(2) SPECIAL RULE.—In the case of any taxable year beginning in 1990, only amounts paid before October 1, 1990, by the employer for coverage for the employee, his spouse, or his dependents under a qualified group legal services plan for periods before October 1, 1990, shall be taken into account in determining the amount excluded under section 120 of the Internal Revenue Code of 1986 with respect to such employee for such taxable year.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years ending after December 31, 1988.

SEC. 7103. EXTENSION AND MODIFICATION OF TARGETED JOBS CREDIT.

(a) EXTENSION.—Paragraph (4) of section 51(c) (relating to termination) is amended by striking "December 31, 1989" and inserting "September 30, 1990".

(b) EXTENSION OF AUTHORIZATION.—Paragraph (2) of section 261(f) of the Economic Recovery Tax Act of 1981 is amended by striking "and 1989" and inserting "1989, and 1990".

(c) MODIFICATION OF REQUEST FOR CERTIFICATION.—

(1) IN GENERAL.—Paragraph (16) of section 51(d) is amended by adding at the end thereof the following new subparagraph:

"(C) EMPLOYER REQUEST MUST SPECIFY POTENTIAL BASIS FOR ELIGIBILITY.—In any request for a certification of an individual as a member of a targeted group, the employer shall—

"(i) specify each subparagraph (but not more than 2) of paragraph (1) by reason of which the employer believes that such individual is such a member, and

"(ii) certify that a good faith effort was made to determine that such individual is such a member."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to individuals who begin work for the employer after December 31, 1989.

SEC. 7104. EXTENSION OF QUALIFIED MORTGAGE BONDS.

(a) IN GENERAL.—Subparagraph (B) of section 143(a)(1) (defining qualified mortgage bond) is amended by striking "December 31, 1989" each place it appears and inserting "September 30, 1990".

(b) MORTGAGE CREDIT CERTIFICATES.—Subsection (h) of section 25 is amended by striking "for any calendar year after 1989" and inserting "for any period after September 30, 1990".

SEC. 7105. EXTENSION OF QUALIFIED SMALL ISSUE BONDS.

Subparagraph (B) of section 144(a)(12) is amended by striking

"substituting '1989' for '1986' " and inserting "substituting 'September 30, 1990' for 'December 31, 1986' ".

SEC. 7106. EXTENSION OF ENERGY INVESTMENT CREDIT FOR SOLAR, GEOTHERMAL, AND OCEAN THERMAL PROPERTY.

The table contained in section 46(b)(2)(A) (relating to energy percentage) is amended by striking "Dec. 31, 1989" in clauses (viii), (ix), and (x) and inserting "Sept. 30, 1990".

SEC. 7107. EXTENSION OF SPECIAL RULES FOR HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.

(a) EXTENSION.—

(1) GENERAL RULE.—Paragraph (5) of section 162(1) (relating to special rules for health insurance costs of self-employed individuals) is amended by striking "December 31, 1989" and inserting "September 30, 1990".

(2) SPECIAL RULE.—In the case of any taxable year beginning in 1990—

(A) only amounts paid before October 1, 1990, by the individual for insurance coverage for periods before October 1, 1990, shall be taken into account in determining the amount deductible under section 162(l) of the Internal Revenue Code of 1986 with respect to such individual for such taxable year, and

(B) for purposes of section 162(l)(2)(A) of such Code, the amount of the earned income described in such paragraph taken into account for such taxable year shall be the amount which bears the same ratio to the total amount of such earned income as the number of months in such taxable year ending before October 1, 1990, bears to the number of months in such taxable year.

(b) SPECIAL RULE FOR CERTAIN S CORPORATION SHAREHOLDERS.—Subsection (1) of section 162 (as amended by subsection (a) is amended by redesignating paragraph (5) as paragraph (6) and by inserting after paragraph (4) the following new paragraph:

"(5) TREATMENT OF CERTAIN S CORPORATION SHAREHOLDERS.—This subsection shall apply in the case of any individual treated as a partner under section 1372(a), except that—

"(A) for purposes of this subsection, such individual's wages (as defined in section 3121) from the S corporation shall be treated as such individual's earned income (within the meaning of section 401(c)(1)), and

"(B) there shall be such adjustments in the application of this subsection as the Secretary may by regulations prescribe."

EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1989.

SEC. 7108. EXTENSION AND MODIFICATION OF LOW-INCOME HOUSING CREDIT.

(a) EXTENSION.—

(1) IN GENERAL.—Subsection (n) of section 42 (relating to low-income housing credit) is amended to read as follows—

"(n) TERMINATION.—

"(1) IN GENERAL.—Except as provided in paragraph (2), for any calendar year after 1990—

"(A) clause (i) of subsection (h)(3)(C) shall not apply, and

"(B) subsection (h)(4) shall not apply to any building placed in service after 1990.

"(2) EXCEPTION FOR BOND-FINANCED BUILDINGS IN PROGRESS.—For purposes of paragraph (1)(B), a building shall be treated as placed in service before 1990 if—

"(A) the bonds with respect to such building are issued before 1990,

"(B) such building is constructed, reconstructed, or rehabilitated by the taxpayer,

"(C) more than 10 percent of the reasonably anticipated cost of such construction, reconstruction, or rehabilitation has been incurred as of January 1, 1990, and some of such cost is incurred on or after such date, and

"(D) such building is placed in service before January 1, 1992.

(2) SPECIAL RULE.—In the case of calendar year 1990, section 42(h)(3)(C)(i) of the Internal Revenue Code of 1986 (as amended by subsection (b)(1)) shall be applied by substituting "$.9375" for "$1.25".

(b) 1-YEAR CARRYOVER OF UNUSED CREDIT AUTHORITY, ETC.—

(1) IN GENERAL.—Section 42(h)(3) (relating to housing credit dollar amount for agencies) is amended by redesignating subparagraphs (D), (E), and (F) as subparagraph (C) and inserting the following new subparagraphs:

"(C) STATE HOUSING CREDIT CEILING.—The State housing credit ceiling applicable to any State for any calendar year shall be an amount equal to the sum of—

"(i) $1.25 multiplied by the State population,

"(ii) the unused State housing credit ceiling (if any) of such State for the preceding calendar year,

"(iii) the amount of State housing credit ceiling returned in the calendar year, plus

"(iv) the amount (if any) allocated under subparagraph (D) to such State by the Secretary.

For purposes of clause (ii), the unused State housing credit ceiling for any calendar year is the excess (if any) of the amount described in clause (i) over the aggregate housing credit dollar amount allocated for such year. For purposes of clause (iii), the amount of State housing credit ceiling returned in the calendar year equals the housing credit dollar amount previously allocated within the State to any project which does not become a qualified low-income housing project within the period required by this section or the terms of the allocation or to any project with respect to which an allocation is canceled by mutual consent of the housing credit agency and the allocation recipient.

"(D) UNUSED HOUSING CREDIT CARRYOVERS ALLOCATED AMONG CERTAIN STATES.—

"(i) IN GENERAL.—The unused housing credit carryover of a State for any calendar year shall be assigned to the Secretary for allocation among qualified States for the succeeding calendar year.

"(ii) UNUSED HOUSING CREDIT CARRYOVER.—For purposes of this subparagraph, the unused housing credit carryover of a State for any calendar year is the excess (if any) of the unused State housing credit ceiling for such year (as defined in subparagraph (C)(ii)) over the excess (if any) of—

"(I) the aggregate housing credit dollar amount allocated for such year, over

"(II) the amount described in clause (i) of subparagraph (C).

"(iii) FORMULA FOR ALLOCATION OF UNUSED HOUSING CREDIT CARRYOVERS AMONG QUALIFIED STATES.—The amount allocated under this subparagraph to a qualified State for any calendar year shall be the amount determined by the Secretary to bear the same ratio to the aggregate unused housing credit carryovers of all States for the preceding calendar year as such State's population for the calendar year bears to the population of all qualified States for the calendar year. For purposes of the preceding sentence, population shall be determined in accordance with section 146(j).

"(iv) QUALIFIED STATE.—For purposes of this subparagraph, the term 'qualified State' means, with respect to a calendar year, any State—

"(I) which allocated its entire State housing credit ceiling for the preceding calendar year, and

"(II) for which a request is made (not later than May 1 of the calendar year) to receive an allocation under clause (iii)."

(2) CONFORMING AMENDMENTS.—

(A) Subparagraph (E) of section 42(h)(5) is amended by striking "subparagraph (E)" and inserting "subparagraph (F)".

(B) Paragraph (6) of section 42(h) is amended by striking subparagraph (B) and by redesignating subparagraphs (C), (D), and (E) as subparagraphs (B), (C), and (D), respectively.

(c) BUILDINGS ELIGIBLE FOR CREDIT ONLY IF MINIMUM LONG-TERM COMMITMENT TO LOW-INCOME HOUSING.—

(1) IN GENERAL.—Section 42(h) (relating to limitation on aggregate credit allowable with respect to projects located in a State) is amended by redesignating paragraphs (6) and (7) as paragraphs (7) and (8), respectively, and by inserting after paragraph (5) the following new paragraph:

"(6) BUILDINGS ELIGIBLE FOR CREDIT ONLY IF MINIMUM LONG-TERM COMMITMENT TO LOW-INCOME HOUSING.—

"(A) IN GENERAL.—No credit shall be allowed by reason of this section with respect to any building for the taxable year unless an extended low-income housing commitment is in effect as of the end of such taxable year.

"(B) EXTENDED LOW-INCOME HOUSING COMMITMENT.—For purposes of this paragraph, the term 'extended low-income housing commitment' means any agreement between the taxpayer and the housing credit agency—

"(i) which requires that the applicable fraction (as defined in subsection (c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in such agreement.

"(ii) which allows individuals who meet the income limitation applicable to the building under subsection (g) (whether prospective, present, or former occupants of the building) the right to enforce in any State court the requirement of clause (i),

"(iii) which is binding on all successors of the taxpayer, and

"(iv) which, with respect to the property, is recorded pursuant to State law as a restrictive covenant.

"(C) ALLOCATION OF CREDIT MAY NOT EXCEED AMOUNT NECESSARY TO SUPPORT COMMITMENT.—

"(i) IN GENERAL.—The housing credit dollar amount allocated to any building may not exceed the amount necessary to support the applicable fraction specified in the extended low-income housing commitment for such building, including any increase in such fraction pursuant to the application of subsection (f)(3) if such increase is reflected in an amended low-income housing commitment.

"(ii) BUILDINGS FINANCED BY TAX-EXEMPT BONDS.—If paragraph (4) applies to any building the amount of credit allowed in any taxable year may not exceed the amount necessary to support the applicable fraction specified in the extended low-income housing commitment for such building. Such commitment may be amended to increase such fraction.

"(D) EXTENDED USE PERIOD.—For purposes of this paragraph, the term 'extended use period' means the period—

"(i) beginning on the 1st day in the compliance period on which such building is part of a qualified low-income housing project, and

"(ii) ending on the later of—

"(I) the date specified by such agency in such agreement, or

"(II) the date which is 15 years after the close of the compliance period.

"(E) EXCEPTIONS IF FORECLOSURE OR IF NO BUYER WILLING TO MAINTAIN LOW-INCOME STATUS.—

"(i) IN GENERAL.—The extended use period for any building shall terminate—

"(I) on the date the building is acquired by foreclosure (or instrument in lieu of foreclosure), or

"(II) on the last day of the period specified in subparagraph (I) if the housing credit agency is unable to present during such period a qualified contract for the acquisition of the low-income portion of the building by any person who will contin-

ue to operate such portion as a qualified low-income building.

Subclause (II) shall not apply to the extent more stringent requirements are provided in the agreement or in State law.

"(ii) EVICTION, ETC. OF EXISTING LOW-INCOME TENANTS NOT PERMITTED.—The termination of an extended use period under clause (i) shall not be construed to permit before the close of the 3-year period following such termination—

"(I) the eviction or the termination of tenancy (other than for good cause) of an existing tenant of any low-income unit, or

"(II) any increase in the gross rent with respect to such unit.

"(F) QUALIFIED CONTRACT.—For purposes of subparagraph (E), the term 'qualified contract' means a bona fide contract to acquire (within a reasonable period after the contract is entered into) the low-income portion of the building for an amount not less than the applicable fraction (specified in the extended low-income housing commitment) of—

"(i) the sum of—

"(I) the outstanding indebtedness secured by, or with respect to, the building,

"(II) the adjusted investor equity in the building, plus

"(III) other capital contributions not reflected in the amounts described in subclause (I) or (II), reduced by

"(ii) cash distributions from (or available for distribution from) the project.

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this paragraph, including regulations to prevent the manipulation of the amount determined under the preceding sentence.

"(G) ADJUSTED INVESTOR EQUITY.—

"(i) IN GENERAL.—For purposes of subparagraph (E), the term 'adjusted investor equity' mens, with respect to any calendar year, the aggregate amount of cash taxpayers invested with respect to the project increased by the amount equal to—

"(I) such amount, multiplied by

"(II) the cost-of-living adjustment for such calendar year, determined under section 1(f)(3) by substituting the base calendar year for 'calendar year 1987'.

An amount shall be taken into account as an investment in the project only to the extent there was an obligation to invest such amount as of the beginning of the credit period and to the extent such amount is reflected in the adjusted basis of the project.

"(ii) COST-OF-LIVING INCREASES IN EXCESS OF 5 PERCENT NOT TAKEN INTO ACCOUNT.—Under regulations prescribed by the Secretary, if the CPI for any calendar year (as defined in section 1(f)(4)) exceeds the CPI for the preceding calendar year by more than 5 percent, the CPI for the base calendar year shall be increased such that such excess shall never be taken into account under clause (i).

"(III) BASE CALENDAR YEAR.—For purposes of this subparagraph, the term 'base calendar year' means the calendar year with or within which the 1st taxable year of the credit period ends.

"(H) LOW-INCOME PORTION.—For purposes of this paragraph, the low-income portion of a building is the portion of such building equal to the applicable fraction specified in the extended low-income housing commitment for the building.

"(I) PERIOD FOR FINDING BUYER.—The period referred to in this subparagraph is the 1-year period beginning on the date (after the 14th year of the compliance period) the taxpayer submits a written request to the housing credit agency to find a period to acquire the taxpayer's interest in the low-income portion of the building.

"(J) SALES OF LESS THAN LOW-INCOME PORTION OF BUILDING.—In the case of a sale or exchange of only a portion of the low-income portion of the building, only the same portion (as the portion sold or exchanged) of the amount determined under subparagraph (F) shall be taken into account thereunder.

"(K) EFFECT OF NONCOMPLIANCE.—If during a taxable year, there is a determination that an extended low-income housing agreement was not in effect as of the beginning of such year, such determination shall not apply to any period before such year and subparagraph (A) shall be applied without regard to such determination if the failure is corrected within 1 year from the date of the determination.

"(L) PROJECTS WHICH CONSIST OF MORE THAN 1 BUILDING.—The application of this paragraph to projects which consist of more than 1 building shall be made under regulations prescribed by the Secretary."

(2) CONFORMING AMENDMENT.—Subparagraph (C) of section 42(b)(3) is amended by striking "subsection (h)(6))" and inserting "subsection (h)(7))".

(d) CREDIT FOR ACQUISITION OF EXISTING BUILDING TO APPLY ONLY IF BUILDING TO BE REHABILITATED; INCREASE IN REQUIRED REHABILITATION EXPENDITURES.—

(1) IN GENERAL.—Subparagraph (B) of section 42(d)(2) is amended by striking "and" at the end of clause (ii), by striking the period at the end of clause (iii) and inserting ", and", and by adding at the end thereof the following new clause:

"(iv) except as provided in subsection (f)(5), a credit is allowable under subsection (a) by reason of subsection (e) with respect to the building."

(2) CREDIT PERIOD FOR EXISTING BUILDINGS NOT TO BEGIN BEFORE REHABILITATION CREDIT ALLOWED.—Subsection (f) of section 42 (relating to definition and special rules relating to credit period), as amended by subtitle H, is amended by adding at the end thereof the following new paragraph:

"(5) CREDIT PERIOD FOR EXISTING BUILDINGS NOT TO BEGIN BEFORE REHABILITATION CREDIT ALLOWED.—

"(A) IN GENERAL.—The credit period for an existing building shall not begin before the 1st taxable year of the credit period for rehabilitation expenditures with respect to the building.

"(B) ACQUISITION CREDIT ALLOWED FOR CERTAIN BUILDINGS NOT ALLOWED A REHABILITATION CREDIT.—

"(i) IN GENERAL.—In the case of a building described in clause (ii)—

"(I) subsection (d)(2)(B)(iv) shall not apply, and

"(II) the credit period for such building shall not begin before the taxable year which would be the 1st taxable year of the credit period for rehabilitation expenditures with respect to the building under the modifications described in clause (ii)(II).

"(ii) BUILDING DESCRIBED.—A building is described in this clause if—

"(I) a waiver is granted under subsection (d)(6)(C) with respect to the acquisition of the building, and

"(II) a credit would be allowed for rehabilitation expenditures with respect to such building if subsection (e)(3)(A)(ii)(I) did not apply and if subsection (e)(3)(A)(ii)(II) were applied by substituting '$2,000' for '$3,000'."

(3) INCREASE IN REQUIRED REHABILITATION EXPENDITURES.—Paragraph (3) of section 42(e) is amended by redesignating subparagraph (B) as subparagraph (C) and by striking so much of such paragraph as precedes such subparagraph and inserting the following:

"(3) MINIMUM EXPENDITURES TO QUALIFY.—

"(A) IN GENERAL.—Paragraph (1) shall apply to rehabilitation expenditures with respect to any building only if—

"(i) the expenditures are allocable to 1 or more low-income units or substantially benefit such units, and

"(ii) the amount of such expenditures during any 24-month period meets the requirements of whichever of the following subclauses requires the greater amount of such expenditures:

"(I) The requirement of this subclause is met if such amount is not less than 10 percent of the adjusted basis of the building (determined as of the 1st day of such period and without regard to paragraphs (2) and (3) of section 1016(a)).

"(II) The requirement of this subclause is met if the qualified basis attributable to such amount, when divided by the number of low-income units in the building, is $3,000 or more.

"(B) EXCEPTION FROM 10 PERCENT REHABILITATION.—In the case of a building acquired by the taxpayer from a governmental unit, at the election of the taxpayer, subparagraph (A)(ii)(I) shall not apply and the credit under this section for such rehabilitation expenditures shall be determined using the percentage applicable under subsection (b)(2)(B)(ii)."

(e) CHANGES IN RULES RELATING TO RENT RESTRICTIONS.—

(1) RENT RESTRICTION DETERMINED ON BASIS OF NUMBER OF BEDROOMS.—

(A) Section 42(g)(2) is amended by redesignating subparagraph (C) as subparagraph (E) and by inserting after subparagraph (B) the following new subparagraphs:

"(C) IMPUTED INCOME LIMITATION APPLICABLE TO UNIT.—For purposes of this paragraph, the imputed income limitation applicable to a unit is the income limitation which would apply under paragraph (1) to individuals occupying the unit of the number of individuals occupying the unit were as follows:

"(i) In the case of a unit which does not have a separate bedroom, 1 individual.

"(ii) In the case of a unit which has 1 or more separate bedrooms, 1.5 individuals for each separate bedroom.

In the case of a project with respect to which a credit is allowable by reason of this section and for which financing is provided by a bond described in section 142(a)(7), the imputed income limitation shall apply in lieu of the otherwise applicable income limitation for purposes of applying section 142(d)(4)(B)(ii).

"(D) TREATMENT OF UNITS OCCUPIED BY INDIVIDUALS WHOSE INCOMES RISE ABOVE LIMIT.—

"(i) IN GENERAL.—Except as provided in clause (ii), notwithstanding an increase in the income of the occupants of a low-income unit above the income limitation applicable under paragraph (1), such unit shall continue to be treated as a low-income unit if the income of such occupants initially met such income limitation.

"(ii) NEXT AVAILABLE UNIT MUST BE RENTED TO LOW-INCOME TENANT IF INCOME RISES ABOVE 140 PERCENT OF INCOME LIMIT.—If the income of the occupants of the unit increases above 140 percent of the income limitation applicable under paragraph (1), clause (i) shall cease to apply to such unit if any residential rental unit in the building (of a size comparable to, or smaller than, such unit) is occupied by a new resident whose income exceeds such income limitation."

(B) Subparagraph (A) of section 42(g)(2) is amended by striking "the income limitation under paragraph (1) applicable to individuals occupying such unit" and inserting "the imputed income limitation applicable to such unit."

(2) REDUCTION IN AREA MEDIAN GROSS INCOME NOT TO REQUIRE REDUCTION OF RENT.—Subparagraph (A) of section 42(g)(2) (relating to rent-restricted units) is amended by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, the amount of the income limitation under paragraph (1) applicable for any period shall not be less than such limitation applicable for the earliest period the building (which contains the unit) was included in the determination of whether the project is a qualified low-income housing project."

(3) EXCLUSION WITH RESPECT TO CONTINUING CARE FACILITIES NOT TO APPLY IN DETERMINING INCOME.—Subparagraph (B) of section 142(d)(2) is amended by adding at the end thereof the following:

"Section 7872(g) shall not apply n determining the income of individuals under this subparagraph."

(f) ADDITIONAL BUILDING ELIGIBLE FOR WAIVER OF 10-YEAR PERIOD APPLICABLE TO ACQUISITIONS OF EXISTING BUILDINGS.—Paragraph (6) of section 42(d) is amended by redesignating subparagraph (6) of section 42(d) is amended by redesignating subparagraph (C) as subparagraph (E) and by inserting after subparagraph (B) the following new subparagraphs:

"(C) LOW-INCOME BUILDINGS WHERE MORTGAGE MAY BE PREPAID.—A waiver may be granted under subparagraph (A) (without regard to any clause thereof) with respect to a federally-assisted building described in clause (ii) or (iii) of subparagraph (B) if—

"(i) the mortgage on such building is eligible for prepayment under subtitle B of the Emergency Low Income Housing Preservation Act of 1987 or under section 502(c) of the Housing Act of 1949 at any time within 1 year after the date of the application for such a waiver.

"(ii) the appropriate Federal official certifies to the Secretary that it is reasonable to expect that, if the waiver is not granted, such building will cease complying with its low-income occupancy requirements, and

"(iii) the eligibility to prepay such mortgage without the approval of the appropriate Federal official is waived by all persons who are so eligible and such waiver is binding on all successors of such persons.

"(D) BUILDINGS ACQUIRED FROM INSURED DEPOSITORY INSTITUTIONS IN DEFAULT.—A waiver may be granted under subparagraph (A) (without regard to any clause thereof) with respect to any building acquired from an insured depository institution in default (as defined in section 3 of the Federal Deposit Insurance Act) or from a receiver or conservator of such an institution."

(g) INCREASE IN CREDIT FOR BUILDINGS IN HIGH COST AREAS.—Paragraph (5) of section 42(d) (relating to eligible basis) is amended by adding at the end thereof the following new subparagraph:

"(D) INCREASE IN CREDIT FOR BUILDINGS IN HIGH COST AREAS.—

"(i) IN GENERAL.—In the case of any building located in a qualified census tract or difficult development area which is designated for purposes of this subparagraph—

"(I) in the case of a new building, the eligible basis of such building shall be 130 percent of such basis determined without regard to this subparagraph, and

"(II) in the case of an existing building, the rehabilitation expenditures taken into account under subsection (e) shall be 130 percent of such expenditures determined without regard to this subparagraph.

"(II) QUALIFIED CENSUS TRACT.—

"(I) IN GENERAL.—The term 'qualified census tract' means any census tract in which 50 percent or more of the households have an income which is less than 60 percent of the area median gross income.

"(II) LIMIT ON MSA'S DESIGNATED.—The portion of a metropolitan statistical area which may be designated for purposes of this subparagraph shall not exceed an area having 20 percent of the population of such metropolitan statistical area.

"(III) DETERMINATION OF AREAS.—For purposes of this clause, each metropolitan statistical area shall be treated as a separate area and all nonmetropolitan areas in a State shall be treated as 1 area.

"(iii) DIFFICULT DEVELOPMENT AREAS.—

"(I) IN GENERAL.—The term 'difficult development areas' means any area designated by the Secretary of Housing and Urban Development as an area which has high construction, land, and utility costs relative to area median gross income.

"(II) LIMIT ON AREAS DESIGNATED.—The portions of metropolitan statistical areas which may be designated for purposes of this subparagraph shall not exceed an aggregate area having 20 percent of the population of such metropolitan statistical areas. A comparable rule shall apply to nonmetropolitan areas.

"(iv) SPECIAL RULES AND DEFINITIONS.—For purposes of this subparagraph—

"(I) population shall be determined on the basis of the most recent decennial census for which data are available,

"(II) area median gross income shall be determined in accordance with subsection (g)(4),

"(III) the term 'metropolitan statistical area' has the same meaning as when used in section 143(k)(2)(B), and

"(IV) the term 'nonmetropolitan area' means any county (or portion thereof) which is not within a metropolitan statistical area."

(h) CHANGES IN RULES RELATING TO BUILDING FOR WHICH CREDIT MAY BE ALLOWED.—

(1) SINGLE-ROOM OCCUPANCY UNITS RENTED ON A MONTHLY BASIS.—Subparagraph (B) of section 42(i)(3) (relating to low income unit) is amended by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, a single-room occupancy unit shall not be treated as used on a transient basis merely because it is rented on a month-by-month basis."

(2) SPECIAL NEEDS HOUSING.—Subparagraph (B) of section 42(g)(2) (relating to gross rent) is amended—

(a) in clause (i), by striking "and" at the end,

(B) in clause (ii), by striking the period at the end and inserting ", and", and

(C) by adding at the end the following:

"(iii) does not include any fee for a supportive service which is paid to the owner of the unit (on the basis of the low-income status of the tenant of the unit) by any governmental program of assistance (or by an organization described in section 501(c)(3) and exempt from tax under section 501(a)) if such program (or organization) provides assistance for rent and the amount of assistance provided for rent is not separable from the amount of assistance provided for supportive services.

For purposes of clause (iii), the term 'supportive service' means any service provided under a planned program of services designed to enable residents of a residential rental property to remain independent and avoid placement in a hospital nursing home, or intermediate care facility for the mentally or physically handicapped. In the case of a single-room occupancy unit or a building described in subsection (i)(3)(B)(iii), such term includes any service provided to assist tenants in locating and retaining permanent housing."

(3) SCATTERED SITE PROJECTS.—Section 42(g) (relating to qualified low-income housing project) is amended by adding at the end thereof the following new paragraph:

"(7) SCATTERED SITE PROJECTS.—Buildings which would (but for their lack of proximity) be treated as a project for purposes of this section shall be so treated if all of the dwelling units in each of the buildings are rent-restricted (within the meaning of paragraph (2)) residential rental units."

(4) OWNER-OCCUPIED BUILDINGS HAVING 4 OR FEWER UNITS ELIGIBLE FOR CREDIT WHERE DEVELOPMENT PLAN.—Section 42(i)(3) (defining low-income unit), as amended by subtitle H, is amended by adding at the end thereof the following new subparagraph:

"(E) OWNER-OCCUPIED BUILDINGS HAVING 4 OR FEWER UNITS ELIGIBLE FOR CREDIT WHERE DEVELOPMENT PLAN.—

"(i) IN GENERAL.—Subparagraph (C) shall not apply to the acquisition or rehabilitation of a building pursuant to a development plan of action sponsored by a State or local government or a qualified nonprofit organization (as defined in subsection (h)(5)(C)).

"(ii) LIMITATION ON CREDIT.—In the case of a building to which clause (i) applies, the applicable fraction shall not exceed 80 percent of the unit fraction.

"(iii) CERTAIN UNRENTED UNITS TREATED AS OWNER-OCCUPIED.—In the case of a building to which clause (i) applies, any unit which is not rented for 90 days or more shall be treated as occupied by the owner of the building as of the 1st day it is not rented."

(5) BUILDINGS RECEIVING SECTION 8 MODERATE REHABILITATION ASSISTANCE OR SIMILAR ASSISTANCE NOT ELIGIBLE FOR CREDIT.—Section 42(b)(1) (relating to applicable percentage for buildings placed in service during 1987) is amended by adding at the end thereof the following new flush sentence:

"A building shall not be treated as described in subparagraph (B) if, at any time during the credit period, moderate rehabilitation assistance is provided with respect to such building under section 8(e)(2) of the United States Housing Act of 1937."

(i) APPLICATION OF CREDIT TO TRANSITIONAL HOUSING FOR THE HOMELESS; DENIAL OF CREDIT FOR SUBSTANDARD HOUSING.—

(1) IN GENERAL.—Subparagraph (B) of section 42(i)(3) (defining low-income unit) is amended to read as follows:

"(B) EXCEPTIONS.—

"(i) IN GENERAL.—A unit shall not be treated as a low-income unit unless the unit is suitable for occupancy and used other than on a transient basis.

"(ii) SUITABILITY FOR OCCUPANCY.—For purposes of clause (i), the suitability of a unit for occupancy shall be determined under regulations prescribed by the Secretary taking into account local health, safety, and building codes.

"(iii) TRANSITIONAL HOUSING FOR HOMELESS.—For purposes of clause (i), a unit shall be considered to be used other than on a transient basis if the unit contains sleeping accommodations and kitchen and bathroom facilities and is located in a building—

"(I) which is used exclusively to facilitate the transition of homeless individuals (within the meaning of section 103 of the Stewart B. McKinney Homeless Assistance Act (42 U.S.C. 11302), as in effect on the date of the enactment of this clause) to independent living within 24 months, and

"(II) in which a governmental entity or qualified nonprofit organization (as defined in subsection (b)(5)) provides such individuals with temporary housing and supportive services designed to assist such individuals in locating and retaining permanent housing.

"(iv) SINGLE-ROOM OCCUPANCY UNITS.—For purposes of clause (i), a single-room occupancy unit shall not be treated as used on a transient basis merely because it is rented on a month-by-month basis."

(2) QUALIFIED BASIS TO INCLUDE PORTION OF BUILDING USED TO PROVIDE SUPPORTIVE SERVICES.—Paragraph (1) of section 42(c) is amended by adding at the end thereof the following new subparagraph:

"(E) QUALIFIED BASIS TO INCLUDE PORTION OF BUILDING USED TO PROVIDE SUPPORTIVE SERVICES FOR HOMELESS.—In the case of a qualified low-income building described in subsection (i)(3)(B)(iii), the qualified basis of such building for any taxable year shall be increased by the lesser of—

"(i) so much of the eligible basis of such building as is used throughout the year to provide supportive services designed to assist tenants in locating and retaining permanent housing, or

"(ii) 20 percent of the qualified basis of such building (determined without regard to this subparagraph)."

(j) VOLUME CAP NOT TO APPLY WHERE 50 PERCENT OR MORE OF BUILDING IS FINANCED WITH TAX-EXEMPT BONDS.—Subparagraph (B) of section 42(h)(4) is amended by striking "70 percent" each place it appears and inserting "50 percent".

(k) BUILDING NOT TREATED AS FEDERALLY SUBSIDIZED BY REASON OF COMMUNITY DEVELOPMENT BLOCK GRANT.—Subparagraph (D) of section 42(i)(2) (defining below market Federal loan) is amended by adding at the end thereof the following new sentence: "Such term shall not include any loan which would be a below market Federal loan solely by reason of assistance provided under section 106, 107, or 108 of the Housing and Community Development Act of 1974 (as in effect on the date of the enactment of this sentence)."

(l) ELIGIBLE BASIS FOR NEW BUILDINGS TO INCLUDE EXPENDITURES BEFORE CLOSE OF 1ST YEAR OF CREDIT PERIOD.—

(1) NEW BUILDINGS.—Paragraph (1) of section 42(d) (relating to eligible basis for new buildings) is amended by inserting before the period "as of the close of the 1st taxable year of the credit period".

(2) EXISTING BUILDINGS.—Subparagraph (A) of section 42(d)(2) (relating to eligible basis for existing buildings) is amended by striking "subparagraph (B)" and all that follows through the end of clause (i) and inserting "subparagraph (B), its adjusted basis as of the close of the 1st taxable year of the credit period, and".

(3) CONFORMING AMENDMENTS.—

(A) Subparagraph (C) of section 42(d)(2) is amended by striking "ACQUISITION COST" in the heading and inserting "ADJUSTED BASIS" and by striking "cost" in the text and inserting "adjusted basis".

(B) Paragraph (5) of section 42(d), as amended by subsection (g), is further amended by striking subparagraph (A), by redesignating subparagraphs (B), (C), and (D) as subparagraphs (A), (B), and (C), respectively, and by striking the paragraph heading and inserting the following:

"(5) SPECIAL RULES FOR DETERMINING ELIGIBLE BASIS.—

(C) Paragraph (5) of section 42(e) is amended by striking "subsection (d)(2)(A)(i)(II)" and inserting "subsection (d)(2)(A)(i)".

(m) HOUSING CREDIT MAY BE ALLOCATED ON PROJECT BASIS.—

(1) IN GENERAL.—Section 42(h)(1) (relating to credit may not exceed credit amount allocated to building) is amended by adding at the end thereof the following new subparagraph:

"(F) ALLOCATION OF CREDIT ON A PROJECT BASIS.—

"(i) IN GENERAL.—In the case of a project which includes (or will include) more than 1 building, an allocation meets the requirements of this subparagraph if—

"(I) the allocation is made to the project for a calendar year during the project period.

"(II) the allocation only applies to buildings placed in service during or after the calendar year for which the allocation is made, and

"(III) the portion of such allocation which is allocated to any building in such project is specified not later than the close of the calendar year in which the building is placed in service.

"(ii) PROJECT PERIOD.—For purposes of clause (i), the term 'project period' means the period—

"(I) beginning with the 1st calendar year for which an allocation may be made for the 1st building placed in service as part of such project, and

"(II) ending with the calendar year the last building is placed in service as part of such project."

(2) CONFORMING AMENDMENT.—Subparagraph (B) of section 42(h)(1) is amended by striking "or (E)" and inserting "(E), or (F)".

(3) PROJECTS WITH MORE THAN 1 BUILDING MUST BE IDENTIFIED.—Section 42(g)(3) (relating to date for meeting requirements) is amended by adding at the end thereof the following new subparagraph:

"(D) PROJECTS WITH MORE THAN 1 BUILDING MUST BE IDENTIFIED.—For purposes of this section, a project shall be treated as consisting of only 1 building unless, before the close of the 1st calendar year in the project period (as defined in subsection (h)(1)(F)(ii), each building which is (or will be) part of such project is identified in such form and manner as the Secretary may provide."

(n) CHANGES IN RULES RELATED TO DEEP RENT SKEWED PROJECTS.—

(1) Clause (iii) of section 142(d)(4)(B) (relating to deep rent skewed project) is amended by striking "1/3" and inserting "1/2".

(2) Section 42(g)(4) (relating to certain rules made applicable) is amended by striking "(other than section 142(d)(4)(B)(iii))".

(o) INCREASED RESPONSIBILITIES FOR HOUSING CREDIT AGENCIES.—Section 42 is amended by redesignating subsections (m) and (n) as subsections (n) and (o), respectively, and by inserting after subsection (l) the following new subsection:

"(m) RESPONSIBILITIES OF HOUSING CREDIT AGENCIES.—

"(1) PLANS FOR ALLOCATION OF CREDIT AMONG PROJECTS.—

"(A) IN GENERAL.—Notwithstanding any other provision of this section, the housing credit dollar amount with respect to any building shall be zero unless—

"(i) such amount was allocated pursuant to a qualified allocation plan of the housing credit agency which is approved by the governmental unit (in accordance with rules similar to the rules of section 147(f)(2) (other than subparagraph (B)(ii) thereof)) of which such agency is a part, and

"(ii) such agency notifies the chief executive officer (or the equivalent) of the local jurisdiction within which the building is located of such project and provides such individual a reasonable opportunity to comment on the project.

"(B) QUALIFIED ALLOCATION PLAN.—For purposes of this paragraph, the term 'qualified allocation plan' means any plan—

"(i) which sets forth selection criteria to be used to determine housing priorities of the housing credit agency which are appropriate to local conditions.

"(ii) which gives the highest priority to those projects as to which the highest percentage of the housing credit dollar amount is to be used for project costs other than the cost of intermediaries unless granting such priority would impede the development of projects in hard to develop areas,

"(iii) which also gives preference in allocating housing credit dollar amounts among selected projects to—

"(I) projects serving the lowest income tenants, and

"(II) projects obligated to serve qualified tenants for the longest periods, and

"(iv) which provides a procedure that the agency will follow in notifying the Internal Revenue Service of noncompliance with the provisions of this section which such agency becomes aware of.

"(C) CERTAIN SELECTION CRITERIA MUST BE USED.—The selection criteria set forth in a qualified allocation plan must include—

"(i) project location,

"(ii) housing needs characteristics,

"(iii) project characteristics,

"(iv) sponsor characteristics,

"(v) participation of local tax-exempt organizations,

"(vi) tenant populations with special housing needs, and

"(vii) public housing waiting lists.

"(D) APPLICATION TO BOND FINANCED PROJECTS.—Subsection (h)(4) shall not apply to any project unless the project satisfies the requirements for allocation of a housing credit dollar amount under the qualified allocation plan applicable to the area in which the project is located.

"(2) CREDIT ALLOCATED TO BUILDING NOT TO EXCEED AMOUNT NECESSARY TO ASSURE PROJECT FEASIBILITY.—

"(A) IN GENERAL.—The housing credit dollar amount allocated to a project shall not exceed the amount the housing credit agency determines is necessary for the financial feasibility of the project and its viability as a qualified low-income housing project throughout the credit period.

"(B) AGENCY EVALUATION.—In making the determination under subparagraph (A), the housing credit agency shall consider—

"(i) the sources and uses of funds and the total financing planned for the project, and

"(ii) any proceeds or receipts expected to be generated by reason of tax benefits.

Such a determination shall not be construed to be a representation or warranty as to the feasibility or viability of the project.

"(C) DETERMINATION MADE WHEN CREDIT AMOUNT APPLIED FOR AND WHEN BUILDING PLACED IN SERVICE.—

"(i) IN GENERAL.—A determination under subparagraph (A) shall be made as of each of the following times:

"(I) The application for the housing credit dollar amount.

"(II) The allocation of the housing credit dollar amount.

"(III) The date the building is placed in service.

"(ii) CERTIFICATION AS TO AMOUNT OF OTHER SUBSIDIES.—Prior to each determination under clause (i), the taxpayer shall certify to the housing credit agency the full extent of all Federal, State, and local subsidies which apply (or which the taxpayer expects to apply) with respect to the building.

"(D) APPLICATION TO BOND FINANCED PROJECTS.—Subsection (h)(4) shall not apply to any project unless the governmental unit which issued the bonds (or on behalf of which the bonds were issued) makes a determination under rules similar to the rules of subparagraphs (A) and (B)."

(o) APPLICATION OF AT-RISK RULES WITH RESPECT TO CERTAIN FINANCING PROVIDED BY QUALIFIED NONPROFIT ORGANIZATIONS.—Subparagraph (D) of section 42(k)(2) (relating to application of at-risk rules) is amended by adding at the end thereof the following new flush sentence:

"In the case of a qualified nonprofit organization which is not described in section 46(c)(8)(D)-(iv)(II) with respect to a building, clause (ii) of this subparagraph shall be applied as if the date described therein were the 90th day after the earlier of the date the building ceases to be a qualified low-income building or the date which is 15 years after the close of a compliance period with respect thereto."

(p) TIME FOR CERTIFICATION.—Section 42(l)(1) (relating to certification with respect to 1st year of credit period) is amended—

(1) by striking "Not later than the 90th day following" and inserting "Following", and

(2) by inserting "at such time and" before "in such form".

(q) IMPACT OF TENANT'S RIGHT OF 1ST REFUSAL TO ACQUIRE PROPERTY.—Subsection (i) of section 42 is amended by adding at the end thereof the following new paragraph:

"(8) IMPACT OF TENANT'S RIGHT OF 1ST REFUSAL TO ACQUIRE PROPERTY.—

"(A) IN GENERAL.—No Federal income tax benefit shall fail to be allowable to the taxpayer with respect to any qualified low-income building merely by reason of a right of 1st refusal held by the tenants of such building to purchase the property after the close of the compliance period for a price which is not less than

the minimum purchase price determined under subparagraph (B).

"(B) MINIMUM PURCHASE PRICE.—For purposes of subparagraph (A), the minimum purchase price under this subparagraph is an amount equal to the sum of—

"(i) the principal amount of outstanding indebtedness secured by the building (other than indebtedness incurred within the 5-year period ending on the date of the sale to the tenants), and

"(ii) all Federal, State, and local taxes attributable to such sale.

Except in the case of Federal income taxes, there shall not be taken into account under clause (ii) any additional tax attributable to the application of clause (ii)."

(r) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to determinations under section 42 of the Internal Revenue Code of 1986 with respect to housing credit dollar amounts allocated from State housing credit ceilings for calendar years after 1989.

(2) BUILDINGS NOT SUBJECT TO ALLOCATION LIMITS.—Except as otherwise provided in this subsection, to the extent paragraph (1) of section 42(h) of such Code does not apply to any building by reason of paragraph (4) thereof, the amendments made by this section shall apply to buildings placed in service after December 31, 1989.

(3) ONE-YEAR CARRYOVER OF UNUSED CREDIT AUTHORITY, ETC.—The amendments made by subsection (b) shall apply to calendar years after 1989, but clauses (ii), (iii), and (iv) of section 42(h)(3)(C) of such Code (as added by this section) shall be applied without regard to allocations for 1989 or any preceding year.

(4) ADDITIONAL BUILDINGS ELIGIBLE FOR WAIVER OF 10-YEAR RULE.—The amendments made by subsection (f) shall take effect on the date of the enactment of this Act.

(5) CERTIFICATION WITH RESPECT TO 1ST YEAR OF CREDIT PERIOD.—The amendment made by subsection (p) shall apply to taxable years ending on or after December 31, 1989.

(6) CERTAIN RULES WHICH APPLY TO BONDS.—Paragraphs (1)(D) and (2)(D) of section 42(m) of such Code, as added by this section, shall apply to obligations issued December 31, 1989.

(7) CLARIFICATIONS.—The amendments made by the following provisions of this section shall apply as if included in the amendments made by section 252 of the Tax Reform Act of 1986:

(A) Paragraph (1) of subsection (h) (relating to units rented on a monthly basis).

(B) Subsection (1) (relating to eligible basis for new buildings to include expenditures before close of 1st year of credit period).

(8) GUIDANCE ON DIFFICULT DEVELOPMENT AREAS AND POSTING OF BOND TO AVOID RECAPTURE.—Not later than 180 days after the date of the enactment of this Act—

(A) the Secretary of Housing and Urban Development shall publish initial guidance on the designation of difficult development areas under section 42(d)(5)(C) of such Code, as added by this section, and

(B) the Secretary of the Treasury shall publish initial guidance under section 42(j)(6) of such Code (relating to no recapture on disposition of building (or interest therein) where bond posted).

SEC. 7109. LOW-INCOME HOUSING CREDIT EXEMPT FROM INCOME PHASE-OUT OF $25,000 EXEMPTION FROM PASSIVE LOSS RULES.

(a) IN GENERAL.—Paragraph (3) of section 469(i) (relating to phaseout of exemption) is amended by redesignating subparagraph (D) as subparagraph (E) and by striking subparagraphs (B) and (C) and inserting the following new subparagraphs:

"(B) SPECIAL PHASE-OUT REHABILITATION CREDIT.—In the case of any portion of the passive activity credit for any taxable year which is attributable to the rehabilitation investment credit (within the meaning of section 48(o)), subparagraph (A) shall be applied by substituting '$200,000' for $100,000'.

"(C) EXCEPTION FOR LOW-INCOME HOUSING CREDIT.—Subparagraph (A) shall not apply to any portion of the passive activity credit for any taxable year which is attributable to any credit determined under section 42.

"(D) ORDERING RULES TO REFLECT EXCEPTION AND SEPARATE PHASE-OUT.—If subparagraph (B) or (C) applies for any taxable year, paragraph (1) shall be applied—

"(i) first to the passive activity loss,

"(ii) second to the portion of the passive activity credit to which subparagraph (B) or (C) does not apply,

"(iii) third to the portion of such credit to which subparagraph (B) applies, and

"(iv) then to the portion of such credit to which subparagraph (C) applies."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to property placed in service after December 31, 1989, in taxable years ending after such date.

(2) SPECIAL RULE WHERE INTEREST HELD IN PASS-THRU ENTITY.—In the case of a taxpayer who holds an indirect interest in property described in paragraph (1), the amendments made by this section shall apply only if such interest is acquired after December 31, 1989.

SEC. 7110. EXTENSION AND MODIFICATION OF RESEARCH CREDIT.

(a) EXTENSION.—

(1) IN GENERAL.—Subsection (h) of section 41 (relating to termination), as redesignated by subtitle H, is amended—

(A) by striking "December 31, 1989" each place it appears and inserting "December 31, 1990", and

(B) by striking "January 1, 1990" each place it appears and inserting "January 1, 1991".

(2) SPECIAL RULES.—

(A) In the case of any taxable year which begins before October 1, 1990, and ends after Septem-

ber 30, 1990, the amount treated as the qualified research expenses for such taxable year for purposes of section 41 of the Internal Revenue Code of 1986 shall be the amount which bears the same ratio to the amount which would have been determined for such taxable year without regard to this subparagraph as the number of days in such taxable year before October 1, 1990, bears to the total number of days in such taxable year before January 1, 1991.

(B) In the case of a taxable year described in subparagraph (A), paragraph (2) of section 41(h) of such Code, as so redesignated, shall be applied by substituting "October 1, 1990" for "January 1, 1991" each place it appears and by substituting "September 30, 1990" for December 31, 1990".

(3) CONFORMING AMENDMENT.—Subparagraph (D) of section 28(b)(1) is amended by striking "December 31, 1989" and inserting "December 31, 1990".

(b) CHANGES IN COMPUTATION OF INCREMENTAL CREDIT.—

(1) IN GENERAL.—Subsection (c) of section 41 is amended to read as follows:

"(c) BASE AMOUNT—

"(1) IN GENERAL.—The term 'base amount' means the product of—

"(A) the fixed-base percentage, and

"(B) the average annual gross receipts of the taxpayer for the 4 taxable years preceding the taxable year for which the credit is being determined (hereinafter in this subsection referred to as the 'credit year').

"(2) MINIMUM BASE AMOUNT.—In no event shall the base amount be less than 50 percent of the qualified research expenses for the credit year.

"(3) FIXED-BASE PERCENTAGE.—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, the fixed-base percentage is the percentage which the aggregate qualified research expenses of the taxpayer for taxable years beginning after December 31, 1983, and before January 1, 1989, is of the aggregate gross receipts of the taxpayer for such taxable years.

"(B) START-UP COMPANIES.—

"(i) TAXPAYERS TO WHICH SUBPARAGRAPH APPLIES.—The fixed-base percentage shall be determined under this subparagraph if there are fewer than 3 taxable years beginning after December 31, 1983, and before January 1, 1989, in which the taxpayer had both gross receipts and qualified research expenses.

"(ii) FIXED-BASE PERCENTAGE—In a case to which this subparagraph applies, the fixed-base percentage is 3 percent.

"(iii) TREATMENT OF DE MINIMIS AMOUNTS OF GROSS RECEIPTS AND QUALIFIED RESEARCH EXPENSES.—The Secretary may prescribe regulations providing that de minimus amounts of gross receipts and qualified research expenses shall be disregarded under clause (i).

"(C) MAXIMUM FIXED-BASE PERCENTAGE.—In no event shall the fixed-base percentage exceed 16 percent.

"(D) ROUNDING—The percentages determined under subparagraph (A) shall be rounded to the nearest 1/100th of 1 percent.

"(4) CONSISTENT TREATMENT OF EXPENSES REQUIRED.—

"(A) IN GENERAL.—Notwithstanding whether the period for filing a claim for credit or refund has expired for any taxable year taken into account in determining the fixed-base percentage, the qualified research expenses taken into account in computing such percentage shall be determined on a basis consistent with the determination of qualified research expenses for the credit year.

"(B) PREVENTION OF DISTORTIONS.—The Secretary may prescribe regulations to prevent distortions in calculating a taxpayer's qualified research expenses or gross receipts caused by a change in accounting methods used by such taxpayer between the current year and a year taken into account in computing such taxpayer's fixed-base percentage.

"(5) GROSS RECEIPTS.—For purposes of this subsection, gross receipts for any taxable year shall be reduced by returns and allowances made during the taxable year. In the case of a foreign corporation, there shall be taken into account only gross receipts which are effectively connected with the conduct of a trade or business within the United States."

(2) CONFORMING AMENDMENTS.—

(A) Subparagraph (B) of section 41(a)(1) is amended to read as follows:

"(B) the base amount, and".

(B) Clause (ii) of section 41(e)(7)(C) is amended by striking "base period research expenses" and inserting "base amount".

(C) Paragraph (1) of section 41(f) (relating to aggregation of expenditures) is amended by striking "proportionate share of the increase in qualified research expenses" each place it appears and inserting "proportionate shares of the qualified research expenses and basic research payments".

(D) Subparagraph (A) of section 41(f)(3) is amended—

(i) by striking "June 30, 1980" and inserting "December 31, 1983", and

(ii) by inserting before the period ", and the gross receipts of the taxpayer for such periods shall be increased by so much of the gross receipts of such predecessor with respect to the acquired trade or business as is attributable to such portion".

(E) Subparagraph (B) of section 41(f)(3) is amended—

(i) by striking "June 30, 1980" and inserting "December 31, 1983", and

(ii) by inserting before the period ", and the gross receipts of the taxpayer for such periods shall be decreased by so much of the gross receipts as is attributable to such portion".

(F)(i) Subparagraph (C) of section 41(f)(3) is amended by strik-

ing "for the base period" and all that follows and inserting "for the taxable years taken into account in computing the fixed-base percentage shall be increased by the lesser of—

"(i) the amount of the decrease under subparagraph (B) which is allocable to taxable years so taken into account, or

"(ii) the product of the number of taxable years so taken into account, multiplied by the amount of the reimbursement described in this subparagraph."

(ii) The heading for such subparagraph (C) is amended to read as follows:

"(C) CERTAIN REIMBURSEMENTS TAKEN INTO ACCOUNT IN DETERMINING FIXED-BASE PERCENTAGE.—".

(G) Paragraph (4) of section 41(f) is amended by inserting "and gross receipts" after "qualified research expenses".

(H) Paragraph (2) of section 41(h), as redesignated by subtitle H, is amended—

(i) by striking "BASE PERIOD EXPENSES" in the heading and inserting "BASE AMOUNT", and

(ii) by striking "any amount for any base period" and all that follows through "such base period" and inserting "the base amount with respect to such taxable year shall be the amount which bears the same ratio to the base amount for such year (determined without regard to this paragraph)".

(b) TRADE OR BUSINESS REQUIREMENT DISREGARD FOR IN-HOUSE RESEARCH EXPENSES OF CERTAIN START-UP VENTURES.—Subsection (b) of section 41 (defining qualified research expenses) is amended by adding at the end thereof the following new paragraph:

"(4) TRADE OR BUSINESS REQUIREMENT DISREGARDED FOR IN-HOUSE RESEARCH EXPENSES OF CERTAIN STARTUP VENTURES.—In the case of in-house research expenses, a taxpayer shall be treated as meeting the trade or business requirement of paragraph (1) if, at the time such in-house research expenses are paid or incurred, the principal purpose of the taxpayer in making such expenditures is to use the results of the research in the active conduct of a future trade or business—

"(A) of the taxpayer, or

"(B) of 1 or more other persons who with the taxpayer are treated as a single taxpayer under subsection (f)(1)."

(c) FULL DISALLOWANCE OF DEDUCTION FOR QUALIFIED RESEARCH EXPENSES.—

(1) Subsection (c) of section 280C, as amended by subtitle H, is further amended by striking "50 percent of" each place it appears.

(2) Paragraph (2) of section 196(d) is amended by inserting before the period "for a taxable year beginning before January 1, 1990".

(d) ONLY REASONABLE RESEARCH EXPENDITURES ELIGIBLE FOR SECTION 174.—Section 174 is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) ONLY REASONABLE RESEARCH EXPENDITURES ELIGIBLE.—This section shall apply to a research or experimental expenditure only to the extent that the amount thereof is reasonable under the circumstances."

(e) EFFECTIVE DATE.—The amendments made by this section (other than subsection (a)) shall apply to taxable years beginning after December 31, 1989.

SEC. 7111. ALLOCATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.

Section 864 (relating to definitions and special rule) is amended by adding at the end thereof the following new subsection:

"(f) ALLOCATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.—

"(1) IN GENERAL.—For purposes of section 861(b), 862(b), and 863(b), qualified research and experimental expenditures shall be allocated and apportioned as follows:

"(A) Any qualified research and experimental expenditures expended solely to meet legal requirements imposed by a political entity with respect to the improvement or marketing of specific products or processes for purposes not reasonably expected to generate gross income (beyond de minimis amounts) outside the jurisdiction of the political entity shall be allocated only to gross income from sources within such jurisdiction.

"(B) In the case of any qualified research and experimental expenditures (not allocated under subparagraph (A)) to the extent—

"(i) that such expenditures are attributable to activities conducted in the United States, 64 percent of such expenditures shall be allocated and apportioned to income from sources within the United States and deducted from such income in determining the amount of taxable income from sources within the United States, and

"(ii) that such expenditures are attributable to activities conducted outside the United States, 64 percent of such expenditures shall be allocated and apportioned to income from sources outside the United States and deducted from such income in determining the amount of taxable income from sources outside the United States.

"(C) The remaining portion of qualified research and experimental expenditures (not allocated under subparagraphs (A) and (B)) shall be apportioned, at the annual election of the taxpayer, on the basis of gross sales or gross income, except that, if the taxpayer elects to apportion on the basis of gross income, the amount apportioned to income from sources outside the United States shall at least be 30 percent of the amount which would be so apportioned on the basis of gross sales.

"(2) QUALIFIED RESEARCH AND EXPERIMENTAL EXPENDITURES.—For purposes of this section, the term 'qualified research and experimental expenditures' means amounts which are research and experimental expenditures within the meaning of section 174. For purposes of this paragraph, rules similar to the rules of subsection (c) of section 174 shall apply. Any qualified research and experimental expenditures treated as deferred ex-

penses under subsection (b) of section 174 shall be taken into account under this subsection for the taxable year for which such expenditures are allowed as a deduction under such subsection.

"(3) SPECIAL RULES FOR EXPENDITURES ATTRIBUTABLE TO ACTIVITIES CONDUCTED IN SPACE, ETC.—

"(A) IN GENERAL.—Any qualified research and experimental expenditures described in subparagraph (B)—

"(i) if incurred by a United States person, shall be allocated and apportioned under this section in the same manner as if they were attributable to activities conducted in the United States, and

"(ii) if incurred by a person other than a United States person, shall be allocated and apportioned under this section in the same manner as if they were attributable to activities conducted outside the United States.

"(B) DESCRIPTION OF EXPENDITURES.—For purposes of subparagraph (A), qualified research and experimental expenditures are described in this subparagraph if such expenditures are attributable to activities conducted—

"(i) in space,

"(ii) on or under water not within the jurisdiction (as recognized by the United States) of a foreign country, possession of the United States, or the United States, or

"(iii) in Antarctica.

"(4) AFFILIATED GROUP.—

"(A) Except as provided in subparagraph (B), the allocation and apportionment required by paragraph (1) shall be determined as if all members of the affiliated group (as defined in subsection (e)(5)) were a single corporation.

"(B) For purposes of the allocation and apportionment required by paragraph (1)—

"(i) sales and gross income from products produced in whole or in part in a possession by an electing corporation (within the meaning of section 936(h)(5)(E)), and

"(ii) dividends from an electing corporation, shall not be taken into account, except that this subparagraph shall not apply to sales of (and gross income and dividends attributable to sales of) products with respect to which an election under section 936(h)(5)(F) is not in effect.

"(C) The qualified research and experimental expenditures taken into account for purposes of paragraph (1) shall be adjusted to reflect the amount of such expenditures included in computing the cost-sharing amount (determined under section 936(h)(5)(C)(i)(I).

"(D) The Secretary may prescribe such regulations as may be necessary to carry out the purposes of this paragraph, including regulations providing for the source of gross income and the allocation and apportionment of deductions to take into account the adjustments required by subparagraph (C).

"(E) Paragraph (6) of subsection (e) shall not apply to qualified research and experimental expenditures.

"(5) YEAR TO WHICH RULE APPLIES.—

"(A) IN GENERAL.—Except as provided in this paragraph, this subsection shall apply to the taxpayer's first taxable year beginning after August 1, 1989, and before August 2, 1990.

"(B) REDUCTION.—Notwithstanding subparagraph (A) this subsection shall only apply to that portion of the qualified research and experimental expenditures for the taxable year referred to in subparagraph (A) which bears the same ratio to the total amount of such expenditures as—

"(i) the lesser of 9 months or the number of months in the taxable year, bears to

"(ii) the number of months in the taxable year."

Subtitle B—Corporate Provisions

SEC. 7201. LIMITATION ON USE OF GROUP LOSSES TO OFFSET INCOME OF SUBSIDIARY PAYING PREFERRED DIVIDENDS.

(a) GENERAL RULE.—Section 1503 (relating to computation and payment of tax) is amended by adding at the end thereof the following new subsection:

"(f) LIMITATION ON USE OF GROUP LOSSES TO OFFSET INCOME OF SUBSIDIARY PAYING PREFERRED DIVIDENDS.—

"(1) IN GENERAL.—In the case of any subsidiary distributing during any taxable year dividends on any applicable preferred stock—

"(A) no group loss item shall be allowed to reduce the disqualified separately computed income of such subsidiary for such taxable year, and

"(B) no group credit item shall be allowed against the tax imposed by this chapter on such disqualified separately computed income.

"(2) GROUP ITEMS.—For purposes of this subsection—

"(A) GROUP LOSS ITEM.—The term 'group loss item' means any of the following items of any other member of the affiliated group which includes the subsidiary:

"(i) Any net operating loss and any net operating loss carryover or carryback under section 172.

"(ii) Any loss from the sale or exchange of any capital asset and any capital loss carryover or carryback under section 1212.

"(B) GROUP CREDIT ITEM.—The term 'group credit item' means any credit allowable under part IV of subchapter A of chapter 1 (other than section 34) to any other member of the affiliated group which includes the subsidiary and any carryover or carryback of any such credit.

"(3) OTHER DEFINITIONS.—For purposes of this subsection—

"(A) DISQUALIFIED SEPARATELY COMPUTED INCOME.—The term 'disqualified separately computed income' means the portion of the separately computed taxable income of the subsidiary which does not exceed the dividends distributed by the subsidiary during the taxable year on applicable preferred stock.

"(B) SEPARATELY COMPUTED TAXABLE INCOME.—The term 'separately computed taxable income' means the separate taxable

income of the subsidiary for the taxable year determined—

"(i) by taking into account gains and losses from the sale or exchange of a capital asset and section 1231 gains and losses,

"(ii) without regard to any net operating loss or capital loss carryover or carryback, and

"(iii) with such adjustments as the Secretary may prescribe.

"(C) SUBSIDIARY.—The term 'subsidiary' means any corporation which is a member of an affiliated group filing a consolidated return other than the common parent.

"(D) APPLICABLE PREFERRED STOCK.—The term 'applicable preferred stock' means stock described in section 1504(a)(4) in the subsidiary which is—

"(i) issued after November 17, 1989, and

"(ii) held by a person other than a member of the same affiliated group as the subsidiary.

"(4) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the provisions of this subsection, including regulations—

"(A) to prevent the avoidance of this subsection through the transfer of built-in losses to the subsidiary.

"(B) to provide rules for cases in which the subsidiary owns (directly or indirectly) stock in another member of the affiliated group, and

"(C) to provide for the application of this subsection where dividends are not paid currently, where the redemption and liquidation rights of the applicable preferred stock exceed the issue price for such stock, or where the stock is otherwise structured to avoid the purposes of this subsection."

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendment made by this section shall apply to taxable years ending after November 17, 1989.

(2) BINDING CONTRACT EXCEPTION.—For purposes of section 1503(f)(3)(D) of the Internal Revenue Code of 1986, stock issued after November 17, 1989, pursuant to a written binding contract in effect on November 17, 1989, and at all times thereafter before such issuance, shall be treated as issued on November 17, 1989.

(3) SPECIAL RULE WHEN SUBSIDIARY LEAVES GROUP.—If, by reason of a transaction after November 17, 1989, a corporation ceases to be, or becomes, a member of an affiliated group, the stock of such corporation shall be treated, for purposes of section 1503(f)(3)(D) of such Code, as issued on the date of such cessation or commencement, unless such transaction is of a kind which would not result in the recognition of any deferred intercompany gain under the consolidated return regulations by reason of the acquisition of the entire group.

(4) RETIRED STOCK.—

(A) Except as provided in subparagraph (B), if stock issued before November 18, 1989, (or described in paragraph (2)), is retired or acquired after November 17, 1989, by the corporation or another member of the same affiliated group, such stock shall be treated, for purposes of section 1503(f)(3)(D) of such Code, as issued on the date of such retirement or acquisition.

(B) Subparagraph (A) shall not apply to any retirement or acquisition pursuant to an obligation to reissue under a binding written contract in effect on November 17, 1989, and at all times thereafter before such retirement or acquisition.

(5) AUCTION RATE PREFERRED.—For purposes of section 1503(f)(3)(D) of such Code, auction rate preferred stock shall be treated as issued when the contract requiring the auction became binding.

(6) SPECIAL RULE FOR CERTAIN AUCTION RATE PREFERRED.—For purposes of section 1503(F)(3)(D) of the Internal Revenue Code of 1986, any auction rate preferred stock shall be treated as issued before November 18, 1989, if—

(A) a subsidiary was incorporated before July 10, 1989, for the special purpose of issuing such stock.

(B) a rating agency was retained before July 10, 1989, and

(C) such stock is issued before the date 30 days after the date of the enactment of this Act.

SEC. 7202. TREATMENT OF CERTAIN HIGH YIELD ORIGINAL ISSUE DISCOUNT OBLIGATIONS.

(a) GENERAL RULE.—Subsection (e) of section 163 (relating to interest deductions on original issue discount obligations) is amended by redesignating paragraph (5) as paragraph (6) and by inserting after paragraph (4) the following new paragraph:

"(5) SPECIAL RULES FOR ORIGINAL ISSUE DISCOUNT ON CERTAIN HIGH YIELD OBLIGATIONS—

"(A) IN GENERAL.—In the case of an applicable high yield discount obligation issued by a corporation—

"(i) no deduction shall be allowed under this chapter for the disqualified portion of the original issue discount on such obligation, and

"(ii) the remainder of such original issue discount shall not be allowable as a deduction until paid.

For purposes of clause (ii), rules similar to the rules of subsection (i)(3)(B) shall apply in determining the time when the original issue discount is paid.

"(B) DISQUALIFIED PORTION TREATED AS STOCK DISTRIBUTION FOR PURPOSES OF DIVIDEND RECEIVED DEDUCTION.—

"(i) IN GENERAL.—Solely for purposes of sections 243, 245, 246, and 246A, the dividend equivalent portion of any amount includible in gross income of a corporation under section 1272(a) in respect of an applicable high yield discount obligation shall be treated as a dividend received by such corporation from the corporation issuing such obligation.

"(ii) DIVIDEND EQUIVALENT PORTION.—For purposes of clause (i), the dividend equivalent portion of any amount includible in gross income under section 1272(a) in respect of an applicable high yield discount obligation is the portion of the amount so includible—

"(I) which is attributable to the disqualified portion of

the original issue discount on such obligation, and

"(II) which would have been treated as a dividend if it had been a distribution made by the issuing corporation with respect to stock in such corporation.

"(C) DISQUALIFIED PORTION.—

"(i) IN GENERAL.—For purposes of this paragraph, the disqualified portion of the original issue discount on any applicable high yield discount obligation is the lesser of—

"(I) the amount of such original issue discount, or

"(II) the portion of the total return on such obligation which bears the same ratio to such total return as the disqualified yield on such obligation bears to the yield to maturity on such obligation.

"(ii) DEFINITIONS.—For purposes of clause (i), the term 'disqualified yield' means the excess of the yield to maturity on the obligation over the sum referred to subsection (i)(1)(B), plus 1 percentage point, and the term 'total return' is the amount which would have been the original issue discount on the obligation if interest described in the parenthetical in section 1273(a)(2) were included in the stated redemption price at maturity.

"(D) EXCEPTION FOR S CORPORATIONS.—This paragraph shall not apply to any obligation issued by any corporation for any period for which such corporation is an S corporation.

"(E) EFFECT ON EARNINGS AND PROFITS.—This paragraph shall not apply for purposes of determining earnings and profits; except that, for purposes of determining the dividend equivalent portion of any amount includible in gross income under section 1272(a) in respect of an applicable high yield discount obligation, no reduction shall be made for any amount attributable to the disqualified portion of any original issue discount on such obligation.

"(F) CROSS REFERENCE.—

"For definition of applicable high yield discount obligation, see subsection (i)."

(b) APPLICABLE HIGH YIELD DISCOUNT OBLIGATION.—Section 163 is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) APPLICABLE HIGH YIELD DISCOUNT OBLIGATION.—

"(1) IN GENERAL.—For purposes of this section, the term 'applicable high yield discount obligation' means any debt instrument if—

"(A) the maturity date of such instrument is more than 5 years from the date of issue,

"(B) the yield to maturity on such instrument equals or exceeds the sum of—

"(i) the applicable Federal rate in effect under section 1274(d) for the calendar month in which the obligation is issued, plus

"(ii) 5 percentage points, and

"(C) such instrument has significant original issue discount.

For purposes of subparagraph (B)(i), the Secretary may by regulation permit a rate to be used with respect to any debt instrument which is higher than the applicable Federal rate if the taxpayer establishes to the satisfaction of the Secretary that such higher rate is based on the same principles as the applicable Federal rate and is appropriate for the term of the instrument.

"(2) SIGNIFICANT ORIGINAL ISSUE DISCOUNT.—For purposes of paragraph (1)(C), a debt instrument shall be treated as having significant original issue discount if—

"(A) the aggregate amount which would be includible in gross income with respect to such instrument for periods before the close of any accrual period (as defined in section 1272(a)(5)) ending after the date 5 years after the date of issue, exceeds—

"(B) the sum of—

"(i) the aggregate amount of interest to be paid under the instrument before the close of such accrual period, and

"(ii) the product of the issue price of such instrument (as defined in sections 1273(b) and 1274(a)) and its yield to maturity.

"(3) SPECIAL RULES.—For purposes of determining whether a debt instrument is an applicable high yield discount obligation—

"(A) any payment under the instrument shall be assumed to be made on the last day permitted under the instrument, and

"(B) any payment to be made in the form of another obligation (or stock) of the issuer (or a related person within the meaning of section 453(f)(1) shall be assumed to be made when such obligation (or stock) is required to be paid in cash or in property other than such obligation (or stock).

"(4) DEBT INSTRUMENT.—For purposes of this subsection, the term 'debt instrument' means any instrument which is a debt instrument as defined in section 1275(a).

"(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this subsection and subsection (e)(5), including—

"(A) regulations providing for modifications to the provisions of this subsection and subsection (e)(5) in the case of varying rates of interest, put or call options, indefinite maturities, contingent payments, assumptions of debt instruments, conversion rights, or other circumstances where such modifications are appropriate to carry out the purposes of this subsection and subsection (e)(5), and

"(B) regulations to prevent avoidance of the purposes of this subsection and subsection (e)(5) through the use of issuers other than C corporations, agreements to borrow amounts due under the debt instrument, or other arrangements."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to instruments issued after July 10, 1989.

(2) EXCEPTIONS.—

(A) The amendments made by this section shall not apply to any instrument if—

(i) such instrument is issued in connection with an acquisition—

(I) which is made on or before July 10, 1989,

(II) for which there was a written binding contract in effect on July 10, 1989, and at all times thereafter before such acquisitions, or

(III) for which a tender offer was filed with the Securities and Exchange Commission on or before July 10, 1989.

(ii) the term of such instrument is not greater than—

(I) the term specified in the written documents described in clause (iii), or

(II) if no term is determined under subclause (I), 10 years, and

(iii) the use of such instrument in connection with such acquisition (and the maximum amount of proceeds from such instrument) was determined on or before July 10, 1989, and such determination is evidenced by written documents—

(I) which were transmitted on or before July 10, 1989, between the issuer and any governmental regulatory bodies or prospective parties to the issuance or acquisition, and

(II) which are customarily used for the type of acquisition or financing involved.

(B) The amendments made by this section shall not apply to any instrument issued pursuant to the terms of a debt instrument issued on or before July 10, 1989, or described in subparagraph (A) or (D).

(C) The amendments made by this section shall not apply to any instrument issued to refinance an original issue discount debt instrument to which the amendments made by this section do not apply if—

(i) the maturity date of the refinancing instrument is not later than the maturity date of the refinanced instrument,

(ii) the issue price of the refinancing instrument does not exceed the adjusted issue price of the refinanced instrument,

(iii) the stated redemption price at maturity of the refinancing instrument is not greater than the stated redemption price at maturity of the refinanced instrument, and

(iv) the interest payments required under the refinancing instrument before maturity are not less than (and are paid not later than) the interest payments required under the refinanced instrument.

(D) The amendments made by this section shall not apply to instruments issued after July 10, 1989, pursuant to a reorganization plan in a title 11 or similar case (as defined in section 368(a)(3) of the Internal Revenue Code of 1986) if the amount of proceeds of such instruments, and the maturities of such instruments, do not exceed the amount or maturities specified in the last reorganization plan filed in such case on or before July 10, 1989.

SEC. 7203. SECURITIES TREATED AS BOOT UNDER SECTION 351.

(a) GENERAL RULE.—Section 351(a) (relating to nonrecognition in cases of transfer to corporations controlled by transferor) is amended by striking "or securities".

(b) CONFORMING AMENDMENTS.—

(1) Subsections (b), (d), and (e)(2) of section 351 are each amended by striking "or securities".

(2) Paragraph (2) of section 351(g) is amended by striking "stock, securities, or property" and inserting "stock or property".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section shall apply to transfers after October 2, 1989, in taxable years ending after such date.

(2) BINDING CONTRACT.—The amendments made by this section shall not apply to any transfer pursuant to a written binding contract in effect on October 2, 1989, and at all times thereafter before such transfer.

(3) CORPORATE TRANSFERS.—In the case of property transferred (directly or indirectly through a partnership or otherwise) by a C corporation, paragraphs (1) and (2) shall be applied by substituting "July 11, 1989" for "October 2, 1989". The preceding sentence shall not apply where the corporation meets the requirements of section 1504(a)(2) of the Internal Revenue Code of 1986 with respect to the transferee corporation (and where the transfer is not part of a plan pursuant to which the transferor subsequently fails to meet such requirements).

SEC. 7204. PROVISIONS RELATED TO REGULATED INVESTMENT COMPANIES.

(a) REQUIREMENT TO DISTRIBUTE 98 PERCENT OF ORDINARY INCOME.—

(1) IN GENERAL.—Subparagraph (A) of section 4982(b)(1) (defining required distribution) is amended by striking "97 percent" and inserting "98 percent".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to calendar years ending after July 10, 1989.

(b) TREATMENT OF CERTAIN MUTUAL FUND LOAD CHARGES.—

(1) IN GENERAL.—Section 852 (relating to taxation of regulated investment companies and their shareholders) is amended by adding at the end thereof the following new subsection:

"(f) TREATMENT OF CERTAIN LOAD CHARGES.—

"(1) IN GENERAL.—If—

"(A) the taxpayer incurs a load charge in acquiring stock in a regulated investment company and, by reason of incurring such charge or making such acquisition, the taxpayer acquires a reinvestment right,

"(B) such stock is disposed of before the 91st day after the date on which such stock was acquired, and

"(C) the taxpayer subsequently acquires stock in such regulated investment company or in another regulated investment company and the otherwise applicable load charge is reduced by reason of the reinvestment right,

the load charge referred to in subparagraph (A) (to the extent it does not exceed the reduction referred to in subparagraph (C)) shall not be taken into account for purposes of determining the amount of gain or loss on the disposition referred to in subparagraph (B). To the extent such charge is not taken into account in determining the amount of such gain or loss, such charge shall be treated as incurred in connection with the acquisition referred to in subparagraph (C) (including for purposes of reapplying this paragraph).

"(2) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

"(A) LOAD CHARGE.—The term 'load charge' means any sales or similar charge incurred by a person in acquiring stock of a regulated investment company. Such term does not include any charge incurred by reason of the reinvestment of a dividend.

"(B) REINVESTMENT RIGHT.—The term 'reinvestment right' means any right to acquire stock of 1 or more regulated investment companies without the payment of a load charge or with the payment of a reduced charge.

"(C) NONRECOGNITION TRANSACTIONS.—If the taxpayer acquires stock in a regulated investment company from another person in a transaction in which gain or loss is not recognized, the taxpayer shall succeed to the treatment of such other person under this subsection."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to charges incurred after October 3, 1989, in taxable years ending after such date.

(c) REGULATED INVESTMENT COMPANIES REQUIRED TO ACCRUE DIVIDENDS ON THE EX-DIVIDEND DATE.—

(1) IN GENERAL.—Subsection (b) of section 852 (relating to treatment of companies and shareholders) is amended by adding at the end thereof the following new paragraph:

"(9) DIVIDENDS TREATED AS RECEIVED BY COMPANY ON EX-DIVIDEND DATE.—For purposes of this title, if a regulated investment company is the holder of record of any share of stock on the record date for any dividend payable with respect to such stock, such dividend shall be included in gross income by such company as of the later of—

"(A) the date such share became ex-dividend with respect to such dividend, or

"(B) the date such company acquired such share."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to dividends in cases where the stock becomes ex-dividend after the date of the enactment of this Act.

SEC. 7205. LIMITATION ON THRESHOLD REQUIREMENT UNDER SECTION 382 BUILT-IN GAIN AND LOSS PROVISIONS.

(a) GENERAL RULE.—Clause (i) of section 382(h)(3)(B) (relating to threshold requirement) is amended to read as follows:

"(i) IN GENERAL.—If the amount of the net unrealized built-in gain or net unrealized built-in loss (determined without regard to this subparagraph) of any old loss corporation is not greater than the lesser of—

"(I) 15 percent of the amount determined for purposes of subparagraph (A)(i)(I), or

"(II) $10,000,000,

the net unrealized built-in gain or net unrealized built-in loss shall be zero."

(b) CONFORMING AMENDMENT TO ADJUSTED CURRENT EARNINGS PREFERENCE.—Subparagraph (H) of section 56(g)(4) (relating to treatment of certain ownership changes) is amended by striking clause (ii) and all that follows and inserting the following:

"(ii) there is a net unrealized built-in loss (within the meaning of section 382(h)) with respect to such corporation,

then the adjusted basis of each asset of such corporation (immediately after the ownership change) shall be its proportionate share (determined on the basis of respective fair market values) of the fair market value of the assets of such corporation (determined under section 382(h)) immediately before the ownership change."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to ownership changes and acquisitions after October 2, 1989, in taxable years ending after such date.

(2) BINDING CONTRACT.—The amendments made by this section shall not apply to any ownership change or acquisition pursuant to a written binding contract in effect on October 2, 1989, and at times thereafter before such change or acquisition.

(3) BANKRUPTCY PROCEEDINGS.—In the case of a reorganization described in section 368(a)(1)(G) of the Internal Revenue Code of 1986, or an exchange of debt for stock in a title 11 or similar case (as defined in section 368(a)(3) of such Code), the amendments made by this section shall not apply to any ownership change resulting from such a reorganization or proceeding if a petition in such case was filed with the court before October 3, 1989.

(4) SUBSIDIARIES OF BANKRUPT PARENT.—The amendments made by this section shall not apply to any built-in loss of a corporation which is a member (on October 2, 1989) of an affiliated group the common parent of which (on such date) was subject to title 11 or similar case (as defined in section 368(a)(3) of such Code). The preceding sentence shall apply only if the ownership change or acquisition is pursuant to the plan approved in such proceeding and is before the date 2 years after the date on which the petition which commenced such proceeding was filed.

SEC. 7206. DISTRIBUTIONS ON CERTAIN PREFERRED STOCK TREATED AS EXTRAORDINARY DIVIDENDS.

(A) GENERAL RULE.—Section 1059 (relating to corporate shareholder's basis in stock reduced by nontaxed portion of extraordinary dividends) is amended by striking subsection (f) and inserting the following:

"(f) TREATMENT OF DIVIDENDS ON CERTAIN PREFERRED STOCK.—

"(1) IN GENERAL.—Any dividend with respect to disqualified preferred stock shall be treated as an extraordinary dividend to which

paragraphs (1) and (2) of subsection (a) apply without regard to the period the taxpayer held the stock.

"(2) DISQUALIFIED PREFERRED STOCK.—For purposes of this subsection, the term 'disqualified preferred stock' means any stock which is preferred as to dividends if—

"(A) when issued, such stock has a dividend rate which declines (or can reasonably be expected to decline) in the future,

"(B) the issue price of such stock exceeds its liquidation rights or its stated redemption price, or

"(C) such stock is otherwise structured—

"(i) to avoid the other provisions of this section, and

"(ii) to enable corporate shareholders to reduce tax through a combination of dividend received deductions and loss on the disposition of the stock.

"(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations—

"(1) providing for the application of this section in the case of stock dividends, stock splits, reorganizations, and other similar transactions and in the case of stock held by pass-thru entities, and

"(2) providing that the rules of subsection (f) shall apply in the case of stock which is not preferred as to dividends in cases where stock is structured to avoid the purposes of this section."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by subsection (a) shall apply to stock issued after July 10, 1989, in taxable years ending after such date.

(2) BINDING CONTRACT.—The amendment made by subsection (a) shall not apply to any stock issued pursuant to a written binding contract in effect on July 10, 1989, and at all times thereafter before the stock is issued.

SEC. 7207. REPEAL OF ELECTION TO REDUCE EXCESS LOSS ACCOUNT RECAPTURE BY REDUCING BASIS OF INDEBTEDNESS.

(a) GENERAL RULE.—Subsection (e) of section 1503 (relating to special rule for determining adjustment to basis) is amended by adding at the end thereof the following new paragraph:

"(4) ELIMINATION OF ELECTION TO REDUCE BASIS OF INDEBTEDNESS.—Nothing in the regulations prescribed under section 1502 shall permit any reduction in the amount otherwise included in gross income by reason of an excess loss account if such reduction is on account of a reduction in the basis of indebtedness."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by subsection (a) shall apply to dispositions after July 10, 1989, in taxable years ending after such date.

(2) BINDING CONTRACT.—The amendment made by subsection (a) shall not apply to any disposition pursuant to a written binding contract in effect on July 10, 1989, and at all times thereafter before such disposition.

SEC. 7208. OTHER PROVISIONS RELATING TO TREATMENT OF STOCK AND DEBT; ETC.

(a) CLARIFICATION OF REGULATORY AUTHORITY UNDER SECTION 385.—

(1) IN GENERAL.—Subsection (a) of section 385 (relating to treatment of certain interests in corporations as stock or indebtedness) is amended by inserting "(or as in part stock and in part indebtedness)" before the period at the end thereof.

(2) REGULATIONS NOT TO BE APPLIED RETROACTIVELY.—Any regulations issued pursuant to the authority granted by the amendment made by paragraph (1) shall only apply with respect to instruments issued after the date on which the Secretary of the Treasury or his delegate provides public guidance as to the characterization of such instruments whether by regulation, ruling, or otherwise.

(b) REPORTING OF CERTAIN ACQUISITIONS OR RECAPITALIZATIONS.—

(1) IN GENERAL.—Section 6043 is amended by striking subsection (c) and inserting the following new subsections:

"(c) CHANGES IN CONTROL AND RECAPITALIZATIONS.—If—

"(1) control (as defined in section 304(c)(1)) of a corporation is acquired by any person (or group of persons) in a transaction (or series of related transactions), or

"(2) there is a recapitalization of a corporation or other substantial change in the capital structure of a corporation,

when required by the Secretary, such corporation shall make a return (at such time and in such manner as the Secretary may prescribe) setting forth the identity of the parties to the transaction, the fees involved, the changes in the capital structure involved, and such other information as the Secretary may require with respect to such transaction.

"(d) CROSS REFERENCES.—

"For provisions relating to penalties for failure to file—

"(1) a return under subsection (b), see section 6652(c), or

"(2) a return under subsection (c), see section 6652(1)."

(2) PENALTY.—Section 6652 is amended by redesignating subsection (l) as subsection (m) and by inserting after subsection (k) the following new subsection:

"(l) FAILURE TO FILE RETURN WITH RESPECT TO CERTAIN CORPORATE TRANSACTIONS.—In the case of any failure to make a return required under section 6043(c) containing the information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing to file such return, an amount equal to $500 for each day during which such failure continues, but the total amount imposed under this subsection with respect to any return shall not exceed $100,000."

(3) CONFORMING AMENDMENTS.—

(A) The subsection heading for subsection (a) of section 6043

is amended by striking "CORPORATIONS" and inserting "CORPORATE LIQUIDATING, ETC., TRANSACTIONS".

(B) The section heading for section 6043 is amended to read as follows:

"SEC. 6043. LIQUIDATING; ETC., TRANSACTIONS."

(C) The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by striking the item relating to section 6043 and inserting the following:

"Sec. 6043. Liquidating; etc., transactions."

(4) EFFECTIVE DATE.—The amendments made by this subsection shall apply to transactions after March 31, 1990.

SEC. 7209. ESTIMATED TAX PAYMENTS REQUIRED FOR S CORPORATIONS.

(a) IN GENERAL.—Subsection (g) of section 6655 (relating to failure by corporation to pay estimated income tax) is amended by adding at the end thereof the following new paragraph:

"(4) APPLICATION OF SECTION TO CERTAIN TAXES IMPOSED ON S CORPORATIONS.—In the case of an S corporation, for purposes of this section—

"(A) The following taxes shall be treated as imposed by section 11:

"(i) The tax imposed by section 1374(a) (or the corresponding provisions of prior law).

"(ii) The tax imposed by section 1375(a).

"(iii) Any tax for which the S corporation is liable by reason of section 1371(d)(2).

"(B) Paragraph (2) of subsection (d) shall not apply.

"(C) Clause (ii) of subsection (d)(1)(B) shall be applied as if it read as follows:

" '(ii) the sum of—

" '(I) the amount determined under clause (i) by only taking into account the taxes referred to in clauses (i) and (iii) of subsection (g)(4)(A), and

" '(II) 100 percent of the tax imposed by section 1375(a) which was shown on the return of the corporation for the preceding taxable year.'

"(D) The requirement in the last sentence of subsection (d)(1)(B) that the return for the preceding taxable year show a liability for tax shall not apply.

"(E) Any reference in subsection (e) to taxable income shall be treated as including a reference to the net recognized built-in gain or the excess passive income (as the case may be)."

(b) EFFECTIVE DATE.—The amendment made by this subsection (a) shall apply to taxable years beginning after December 31, 1989.

SEC. 7210. LIMITATION ON DEDUCTION FOR CERTAIN INTEREST PAID TO RELATED PERSON.

(A) GENERAL RULE.—Section 163 (as amended by section 7202) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) LIMITATION ON DEDUCTION FOR CERTAIN INTEREST PAID BY CORPORATION TO RELATED PERSON.—

"(1) LIMITATION.—

"(A) IN GENERAL.—If this subsection applies to any corporation for any taxable year, no deduction shall be allowed under this chapter for disqualified interest paid or accrued by such corporation during such taxable year. The amount disallowed under the preceding sentence shall not exceed the corporation's excess interest expense for the taxable year.

"(B) DISALLOWED AMOUNT CARRIED TO SUCCEEDING TAXABLE YEAR.—Any amount disallowed under subparagraph (A) for any taxable year shall be treated as disqualified interest paid or accrued in the succeeding taxable year.

"(2) CORPORATIONS TO WHICH SUBSECTION APPLIES.—

"(A) IN GENERAL.—This subsection shall apply to any corporation for any taxable year if—

"(i) such corporation has excess interest expense for such taxable year, and

"(ii) the ratio of debt to equity of such corporation as of the close of such taxable year (and on such other days during the taxable year as the Secretary may by regulations prescribe) exceeds 1.5 to 1.

"(B) EXCESS INTEREST EXPENSE.—

"(i) IN GENERAL.—For purposes of this subsection, the term 'excess interest expense' means the excess (if any) of—

"(I) the corporation's net interest expense, over

"(II) the sum of 50 percent of the adjusted taxable income of the corporation plus any excess limitation carryforward under clause (ii).

"(ii) EXCESS LIMITATION CARRYFORWARD.—If a corporation has an excess limitation for any taxable year, the amount of such excess limitation shall be an excess limitation carryforward to the 1st succeeding taxable year and to the 2nd and 3rd succeeding taxable years to the extent not previously taken into account under this clause. The amount of such a carryforward taken into account for any such succeeding taxable year shall not exceed the excess interest expense for such succeeding taxable year (determined without regard to the carryforward from the taxable year of such excess limitation).

" '(iii) EXCESS LIMITATION.—For purposes of clause (i), the term 'excess limitation' means the excess (if any) of—

"(I) 50 percent of the adjusted taxable income of the corporation over

"(II) the corporation's net interest expense.

"(C) RATIO OF DEBT TO EQUITY.—For purposes of this paragraph, the term 'ratio of debt to equity' means the ratio which the total indebtedness of the corporation bears to the sum of its money and all other assets less such total indebtedness. For purposes of the preceding sentence—

"(i) the amount taken into account with respect to any asset shall be the adjusted basis thereof for purposes of determining gain,

"(ii) the amount taken into account with respect to any

indebtedness with original issue discount shall be its issue price plus the portion of the original issue discount previously accrued as determined under the rules of section 1272 (determined without regard to subsection (a)(7) or (b)(4) thereof), and

"(iii) there shall be such other adjustments as the Secretary may by regulations prescribe.

"(3) DISQUALIFIED INTEREST.—For purposes of this subsection—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'disqualified interest' means any interest paid or accrued by the taxpayer (directly or indirectly) to a related person if no tax is imposed by this subtitle with respect to such interest.

"(B) EXCEPTION FOR CERTAIN EXISTING INDEBTEDNESS.—The term 'disqualified interest' does not include any interest paid or accrued under indebtedness with a fixed term—

"(i) which was issued on or before July 10, 1989, or

"(ii) which was issued after such date pursuant to a written binding contract in effect on such date and all times thereafter before such indebtedness was issued.

"(4) RELATED PERSON.—For purposes of this subsection—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'related person' means any person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer.

"(B) SPECIAL RULE FOR CERTAIN PARTNERSHIPS.—

"(i) IN GENERAL.—Any interest paid or accrued to a partnership which (without regard to this subparagraph) is a related person shall not be treated as paid or accrued to a related person if less than 10 percent of the profits and capital interests in such partnership are held by persons with respect to whom no tax is imposed by this subtitle on such interest. The preceding sentence shall not apply to any interest allocable to any partner in such partnership who is a related person to the taxpayer.

"(ii) SPECIAL RULE WHERE TREATY REDUCTION.—If any treaty between the United States and any foreign country reduces the rate of tax imposed by this subtitle on a partner's share of any interest paid or accrued to a partnership, such partner's interests in such partnership shall, for purposes of clause (i), be treated as held in part by a tax-exempt person and in part by a taxable person under rules similar to the rules of paragraph (5)(B).

"(5) SPECIAL RULES FOR DETERMINING WHETHER INTEREST IS SUBJECT TO TAX.—

"(A) TREATMENT OF PASS-THRU ENTITIES.—In the case of any interest paid or accrued to a partnership, the determination of whether any tax is imposed by this subtitle on such interest shall be made at the partner level. Rules similar to the rules of the preceding sentence shall apply in the case of any pass-thru entity other than a partnership and in the case of tiered partnerships and other entities.

"(B) INTEREST TREATED AS TAX-EXEMPT TO EXTENT OF TREATY REDUCTION.—If any treaty between the United States and any foreign country reduces the rate of tax imposed by this subtitle on any interest paid or accrued by the taxpayer to a related person, such interest shall be treated as interest on which no tax is imposed by this subtitle to the extent of the same proportion of such interest as—

"(i) the rate of tax imposed without regard to such treaty, reduced by the rate of tax imposed under the treaty, bears to

"(ii) the rate of tax imposed without regard to the treaty.

"(6) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

"(A) ADJUSTED TAXABLE INCOME.—The term 'adjusted taxable income' means the taxable income of the taxpayer—

"(i) computed without regard to—

"(I) any deduction allowable under this chapter for the net interest expense,

"(II) the amount of any net operating loss deduction under section 172, and

"(III) any deduction allowable for depreciation, amortization, or depletion, and

"(ii) computed with such other adjustments as the Secretary may by regulations prescribe.

"(B) NET INTEREST EXPENSE.—The term 'net interest expense' means the excess (if any) of—

"(i) the interest paid or accrued by the taxpayer during the taxable year, over

"(ii) the amount of interest includible in the gross income of such taxpayer for such taxable year.

The Secretary may by regulations provide for adjustments in determining the amount of net interest expense.

"(C) TREATMENT OF AFFILIATED GROUP.—All members of the same affiliated group (within the meaning of section 1504(a)) shall be treated as 1 taxpayer.

"(7) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this subsection, including—

"(A) such regulations as may be appropriate to prevent the avoidance of the purposes of this subsection,

"(B) regulations providing such adjustments in the case of corporations which are members of an affiliated group as may be appropriate to carry out the purposes of this subsection, and

"(C) regulations for the coordination of this subsection with section 884."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to interest paid or accrued in taxable years beginning after July 10, 1989.

(2) SPECIAL RULE FOR DEMAND LOANS, ETC.—In the case of any demand loan (or other loan without a fixed term) which was outstand-

ing on July 10, 1989, interest on such loan to the extent attributable to periods before September 1, 1989, shall not be treated as disqualified interest for purposes of section 163(j) of the Internal Revenue Code of 1986 (as added by subsection (a)).

SEC. 7211. LIMITATIONS ON REFUNDS DUE TO NET OPERATING LOSS CARRYBACKS OR EXCESS INTEREST ALLOCABLE TO CORPORATE EQUITY REDUCTION TRANSACTIONS.

(a) IN GENERAL.—Paragraph (1) of section 172(b) (relating to years to which loss may be carried) is amended by adding at the end thereof the following new subparagraph:

"(M) EXCESS INTEREST LOSS.—

"(i) IN GENERAL.—If—

"(I) there is a corporate equity reduction transaction, and

"(II) an applicable corporation has a corporate equity reduction interest loss for any loss limitation year ending after August 2, 1989,

then the corporate equity reduction interest loss shall be a net operating loss carryback and carryover to the taxable years described in subparagraphs (A) and (B), except that such loss shall not be carried back to a taxable year preceding the taxable year in which the corporate equity reduction transaction occurs.

"(ii) LOSS LIMITATION YEAR.—For purposes of clause (i) and subsection (m), the term 'loss limitation year' means, with respect to any corporate equity reduction transaction, the taxable year in which such transaction occurs and each of the 2 succeeding taxable years.

"(iii) APPLICABLE CORPORATION.—For purposes of clause (i), the term 'applicable corporation' means a C corporation—

"(I) which acquires stock, or the stock of which is acquired, in a major stock acquisition,

"(II) a corporation making distributions with respect to, or redeeming, its stock in connection with an excess distribution, or

"(III) any successor corporation of a corporation described in subclause (I) or (II).

"(iv) OTHER DEFINITIONS.—

"For definitions of terms used in this subparagraph, see subsection (m)."

(b) CORPORATE EQUITY REDUCTION INTEREST LOANS AND CORPORATE EQUITY REDUCTION TRANSACTION DEFINED.—Section 172 is amended by redesignating subsection (m) as subsection (n) and by inserting after subsection (l) the following new subsection:

"(m) CORPORATE EQUITY REDUCTION INTEREST LOSSES.—For purposes of this section—

"(1) IN GENERAL.—The term 'corporate equity reduction interest loss' means, with respect to any loss limitation year, the excess (if any) of—

"(A) the net operating loss for such taxable year, over

"(B) the net operating loss for such taxable year determined without regard to any allocable interest deductions otherwise taken into account in computing such loss.

"(2) ALLOCABLE INTEREST DEDUCTIONS.—

"(A) IN GENERAL.—The term 'allocable interest deductions' means deductions allowed under this chapter for interest on the portion of any indebtedness allocable to a corporate equity reduction transaction.

"(B) METHOD OF ALLOCATION.—Except as provided in regulations and subparagraph (E), indebtedness shall be allocated to a corporate equity reduction transaction in the manner prescribed under clause (ii) of section 263A(f)(2)(A) (without regard to clause (i) thereof).

"(C) ALLOCABLE DEDUCTIONS NOT TO EXCEED INTEREST INCREASES.—Allocable interest deductions for any loss limitation year shall not exceed the excess (if any) of—

"(i) the amount allowable as a deduction for interest paid or accrued by the taxpayer during the loss limitation year, over

"(ii) the average of such amounts for the 3 taxable years preceding the taxable year in which the corporate equity reduction transaction occurred.

"(D) DE MINIMIS RULE.—A taxpayer shall be treated as having no allocable interest deductions for any taxable year if the amount of such deductions (without regard to this subparagraph) is less than $1,000,000.

"(E) SPECIAL RULE FOR CERTAIN UNFORESEEABLE EVENTS.—If an unforeseeable extraordinary adverse event occurs during a loss limitation year but after the corporate equity reduction transaction—

"(i) indebtedness shall be allocated in the manner described in subparagraph (B) to unreimbursed costs paid or incurred in connection with such event before being allocated to the corporate equity reduction transaction, and

"(ii) the amount determined under subparagraph (C)(i) shall be reduced by the amount of interest on indebtedness described in clause (i).

"(F) TRANSITION RULE.—If any of the 3 taxable years described in subparagraph (C)(ii) end on or before August 2, 1989, the taxpayer may substitute for the amount determined under such subparagraph an amount equal to the interest paid or accrued (determined on an annualized basis) during the taxpayer's taxable year which includes August 3, 1989, on indebtedness of the taxpayer outstanding on August 2, 1989.

"(3) CORPORATE EQUITY REDUCTION TRANSACTION.—

"(A) IN GENERAL.—The term 'corporate equity reduction transaction' means—

"(i) a major stock acquisition, or

"(ii) an excess distribution.

"(B) MAJOR STOCK ACQUISITION.—

"(i) IN GENERAL.—The term 'major stock acquisition' means the acquisition by a corporation pursuant to a plan of such corporation (or any group of persons acting in concert

with such corporation) of stock in another corporation representing 50 percent or more (by vote or value) of the stock in such other corporation,

"(ii) EXCEPTIONS.—The term 'major stock acquisition' shall not include—

"(I) a qualified stock purchase (within the meaning of section 338) to which an election under section 338 applies, or

"(II) except as provided in regulations, an acquisition in which a corporation acquires stock of another corporation which, immediately before the acquisition, was a member of an affiliated group (within the meaning of section 1504(a)) other than the common parent of such group.

"(C) EXCESS DISTRIBUTION.—The term 'excess distribution' means the excess (if any) of—

"(i) the aggregate distributions (including redemptions) made during a taxable year by a corporation with respect to its stock, over

"(ii) the greater of—

"(I) 150 percent of the average of such distributions during the 3 taxable years immediately preceding such taxable year, or

"(II) 10 percent of the fair market value of the stock of such corporation as of the beginning of such taxable year.

"(D) RULES FOR APPLYING SUBPARAGRAPH (B).—For purposes of subparagraph (B)—

"(i) PLANS TO ACQUIRE STOCK.—All plans referred to in subparagraph (B) by any corporation (or group of persons acting in concert with such corporation) with respect to another corporation shall be treated as 1 plan.

"(ii) ACQUISITIONS DURING 24-MONTH PERIOD.—All acquisitions during any 24-month period shall be treated as pursuant to 1 plan.

"(E) RULES FOR APPLYING SUBPARAGRAPH (C).—For purposes of subparagraph (C)—

"(i) CERTAIN PREFERRED STOCK DISREGARDED.—Stock described in section 1504(a)(4), and distributions (including redemptions) with respect to such stock, shall be disregarded.

"(ii) ISSUANCE OF STOCK.—The amounts determined under clauses (i) and (ii)(I) of subparagraph (C) shall be reduced by the aggregate amount of stock issued by the corporation during the applicable period in exchange for money or property other than stock in the corporation.

"(4) OTHER RULES.—

"(A) ORDERING RULE.—For purposes of paragraph (1), in determining the allocable interest deductions taken into account in computing the net operating loss for any taxable year, taxable income for such taxable year shall be treated as having been computed by taking allocable interest deductions into account after all other deductions.

"(B) COORDINATION WITH SUBSECTION (B)(2).—In applying paragraph (2) of subsection (b), the corporate equity reduction interest loss shall be treated in a manner similar to the manner in which a foreign expropriation loss is treated.

"(C) MEMBERS OF AFFILIATED GROUPS.—Except as provided by regulations, all members of an affiliated group filing a consolidated return under section 1501 shall be treated as 1 taxpayer for purposes of this subsection and subsection (b)(1)(M).

"(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations—

"(A) for applying this subsection to successor corporations and in cases where a taxpayer becomes, or ceases to be, a member of an affiliated group filing a consolidated return under section 1501,

"(B) to prevent the avoidance of this subsection through related parties, pass-through entities, and intermediaries, and

"(C) for applying this subsection where more than 1 corporation is involved in a corporate equity reduction transaction.

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section shall apply to corporate equity reduction transactions occurring after August 2, 1989, in taxable years ending after August 2, 1989.

(2) EXCEPTIONS.—In determining whether a corporate equity reduction transaction has occurred after August 2, 1989, there shall not be taken into account—

(A) acquisitions or redemptions of stock, or distributions with respect to stock, occurring on or before August 2, 1989,

(B) acquisitions or redemptions of stock after August 2, 1989, pursuant to a binding written contract (or tender offer filed with the Securities and Exchange Commission) in effect on August 2, 1989, and at all times thereafter before such acquisition or redemption, or

(C) any distribution with respect to stock after August 2, 1989, which was declared on or before August 2, 1989.

Any distribution to which the preceding sentence applies shall be taken into account under section 172(m)(3)(C)(ii)(I) of the Internal Revenue Code of 1986 (relating to base period for distributions).

Subtitle C—Employee Benefit Provisions

PART I—EMPLOYEE STOCK OWNERSHIP PLANS

SEC. 7301. LIMITATIONS ON PARTIAL EXCLUSION OF INTEREST ON LOANS USED TO ACQUIRE EMPLOYER SECURITIES.

(a) EXCLUSION AVAILABLE ONLY WHERE EMPLOYEES RECEIVE SIGNIFICANT OWNERSHIP INTEREST.—Subsection (b) of section 133 (defining securities acquisition loans) is amended by adding at the end thereof the following new paragraph:

"(6) PLAN MUST HOLD MORE THAN 50 PERCENT OF STOCK AFTER ACQUISITION OR TRANSFER.—

"(A) IN GENERAL.—A loan shall not be treated as a securities acquisition loan for purposes of this section unless, immediately

after the acquisition or transfer referred to in subparagraph (A) or (B) of paragraph (1), respectively, the employee stock ownership plan owns more than 50 percent of—

"(i) each class of outstanding stock of the corporation issuing the employer securities, or

"(ii) the total value of all outstanding stock of the corporation.

"(B) FAILURE TO RETAIN MINIMUM STOCK INTEREST.—

"(i) IN GENERAL.—Subsection (a) shall not apply to any interest received with respect to a securities acquisition loan which is allowable to any period during which the employee stock ownership plan does not own stock meeting the requirements of subparagraph (A).

"(ii) EXCEPTION.—To the extent provided by the Secretary, clause (i) shall not apply to any period if, within 90 days of the first date on which the failure occurred (or such longer period not in excess of 180 days as the Secretary may prescribe), the plan acquires stock which results in its meeting the requirements of subparagraph (A).

"(C) STOCK.—For purposes of subparagraph (A)—

"(i) IN GENERAL.—The term 'stock' means stock other than stock described in section 1504(a)(4).

"(ii) TREATMENT OF CERTAIN RIGHTS.—The Secretary may provide that warrants, options, contracts to acquire stock, convertible debt interests and other similar interests be treated as stock for 1 or more purposes under subparagraph (A).

"(D) AGGREGATION RULE.—For purposes of determining whether the requirements of subparagraph (A) are met, an employee stock ownership plan shall be treated as owning stock in the corporation issuing the employer securities which is held by any other employee stock ownership plan which is maintained by—

"(i) the employer maintaining the plan, or

"(ii) any member of a controlled group of corporations (within the meaning of section 409(1)(4)) of which the employer described in clause (i) is a member."

(b) TERM OF LOAN MAY EXCEED 15 YEARS.—Paragraph (1) of section 133(b) is amended by adding at the end thereof the following new sentence: "The term 'securities acquisition loan' shall not include a loan with a term greater than 15 years."

(c) VOTING RIGHTS.—Subsection (b) of section 133, as amended by subsection (a), is amended by adding at the end thereof the following new paragraph:

"(7) VOTING RIGHTS OF EMPLOYER SECURITIES.—A loan shall not be treated as a securities acquisition loan for purposes of this section unless—

"(A) the employee stock ownership plan meets the requirements of section 409(e)(2) with respect to all employer securities acquired by, or transferred to, the plan in connection with such loan (without regard to whether or not the employer has a registration-type class of securities), and

"(B) no stock described in section 409(1)(3) is acquired by, or transferred to, the plan in connection with such loan unless—

"(i) such stock has voting rights equivalent to the stock to which it may be converted, and

"(ii) the requirements of subparagraph (A) are met with respect to such voting rights".

(d) TAX ON DISPOSITION OF SECURITIES BY EMPLOYEE STOCK OWNERSHIP PLANS.—

(1) IN GENERAL.—Chapter 43 is amended by inserting after section 4978A the following new section:

SEC. 4978B. TAX ON DISPOSITION OF EMPLOYER SECURITIES TO WHICH SECTION 133 APPLIED.

"(a) IMPOSITION OF TAX.—In the case of an employee stock ownership plan which has acquired section 133 securities, there is hereby imposed a tax on each taxable event in an amount equal to the amount determined under subsection (b).

"(b) AMOUNT OF TAX.—

"(1) IN GENERAL.—The amount of the tax imposed by subsection (a) shall be equal to 10 percent of the amount realized on the disposition to the extent allocable to section 133 securities under section 4978(b)(2).

"(2) DISPOSITIONS OTHER THAN SALES OR EXCHANGES.—For purposes of paragraph (1), in the case of a disposition of employer securities which is not a sale or exchange, the amount realized on such disposition shall be the fair market value of such securities at the time of disposition.

"(c) TAXABLE EVENT.—For purposes of this section, the term 'taxable event' means any of the following dispositions:

"(1) DISPOSITIONS WITHIN 3 YEARS.—Any disposition of any employer securities by an employee stock ownership plan within 3 years after such plan acquired section 133 securities if—

"(A) the total number of employer securities held by such plan after such disposition is less than the total number of employer securities held after such acquisition, or

"(B) except to the extent provided in regulations, the value of employer securities held by such plan after the disposition is 50 percent or less of the total value of all employer securities as of the time of the disposition.

For purposes of subparagraph (B), the aggregation rule of section 133(b)(6)(D) shall apply.

"(2) STOCK DISPOSED OF BEFORE ALLOCATION.—Any disposition of section 133 securities to which paragraph (1) does not apply if—

"(A) such disposition occurs before such securities are allocated to accounts of participants or their beneficiaries, and

"(B) the proceeds from such disposition are not so allocated.

"(d) SECTION NOT TO APPLY TO CERTAIN DISPOSITIONS.—

"(1) IN GENERAL.—This section shall not apply to any disposition described in paragraph (1), (3), or (4) of section 4978(d).

"(2) CERTAIN REORGANIZATIONS.—For purposes of this section, any exchange of section 133 securities for employer securities of another corporation in any reorga-

nization described in section 368(a)(1) shall not be treated as a disposition, but the employer securities received shall be treated as section 133 securities and as having been held by the plan during the period the securities which were exchanged were held.

"(3) FORCED DISPOSITION OCCURRING BY OPERATION OF STATE LAW.—Any forced disposition of section 133 securities by an employee stock ownership plan occurring by operation of a State law shall not be treated as a disposition. This paragraph shall only apply to securities which, at the time the securities were acquired by the plan, were regularly traded on an established securities market.

"(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) LIABILITY FOR PAYMENT OF TAXES.—The tax imposed by this section shall be paid by the employer.

"(2) SECTION 133 SECURITIES.—The term 'section 133 securities' means employer securities acquired by an employee stock ownership plan in a transaction to which section 133 applied, except that such term shall not include—

"(A) qualified securities (as defined in section 4978(e)(2)), or

"(B) qualified employer securities (as defined in section 4978A(f)(2), as in effect on the day before the date of the enactment of this section).

"(3) DISPOSITION.—The term 'disposition' includes any distribution.

"(4) ORDERING RULES.—For ordering rules for dispositions of employer securities, see section 4978(b)(2)."

(2) CONFORMING AMENDMENT.—The table of sections for chapter 43 is amended by inserting after the item relating to section 4978A the following new item:

"Sec. 4978B. Tax on disposition of employer securities to which section 133 applied."

(e) REPORTING REQUIREMENTS.—Section 6047 (relating to information reports relating to certain trusts or annuity plans) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) EMPLOYEE STOCK OWNERSHIP PLANS.—The Secretary shall require—

"(1) any employer maintaining, or the plan administrator (within the meaning of section 414(g)) of, an employee stock ownership plan—

"(A) which acquired stock in a transaction to which section 133 applies, or

"(B) which holds stock with respect to which section 404(k) applies to dividends paid on such stock,

"(2) any person making or holding a loan to which section 133 applies, or

"(3) both such employer or plan administrator and such person,

to make returns and reports regarding such plan, transaction, or loan to the Secretary and to such other persons as the Secretary may prescribe. Such returns and reports shall be made in such form, shall be made at such time, and shall contain such information as the Secretary may prescribe."

(f) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section shall apply to loans made after July 10, 1989.

(2) BINDING COMMITMENT EXCEPTIONS.—

(A) The amendments made by this section shall not apply to any loan—

(i) which is made pursuant to a binding written commitment in effect on June 6, 1989, and at all times thereafter before such loan is made, or

(ii) to the extent that the proceeds of such loan are used to acquire employer securities pursuant to a written binding contract (or tender offer registered with the Securities and Exchange Commission) in effect on June 6, 1989, and at all times thereafter before such securities are acquired.

(B) The amendments made by this section shall not apply to any loan to which subparagraph (A) does not apply which is made pursuant to a binding written commitment in effect on July 10, 1989, and at all times thereafter before such loan is made. The preceding sentence shall only apply to the extent that the proceeds of such loan are used to acquire employer securities pursuant to a written binding contract (or tender offer registered with the Securities and Exchange Commission) in effect on July 10, 1989, and at all times thereafter before such securities are acquired.

(C) The amendments made by this section shall not apply to any loan made on or before July 10, 1992, pursuant to a written agreement entered into on or before July 10, 1989, if such agreement evidences the intent of the borrower on a periodic basis to enter into securities acquisition loans described in section 133(b)(1)(B) of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of this Act). The preceding sentence shall apply only if one or more securities acquisition loans were made to the borrower on or before July 10, 1989.

(3) REFINANCINGS.—The amendments made by this section shall not apply to loans made after July 10, 1989, to refinance securities acquisition loans (determined without regard to section 133(b)(2) of the Internal Revenue Code of 1986) made on or before such date or to refinance loans described in this paragraph or paragraph (2), (4), or (5) if—

(A) such refinancing loans meet the requirements of such section 133 of such Code (as in effect before such amendments) applicable to such loans,

(B) immediately after the refinancing the principal amount of the loan resulting from the refinancing does not exceed the principal amount of the refinanced loan (immediately before the refinancing), and

(C) the term of such refinancing loan does not extend beyond the later of—

(i) the last day of the term of the original securities acquisition loan, or

(ii) the last day of the 7-year period beginning on the date

the original securities acquisition loan was made.

For purposes of this paragraph, the term "securities acquisition loan" shall include a loan from a corporation to an employee stock ownership plan described in section 133(b)(3) of such Code.

(4) COLLECTIVE BARGAINING AGREEMENTS.—The amendments made by this section shall not apply to any loan to the extent such loan is used to acquire employer securities for an employee stock ownership plan pursuant to a collective bargaining agreement which sets forth the material terms of such employee stock ownership plan and which was agreed to on or before June 6, 1989, by one or more employers and employee representatives (and ratified on or before such date or within a reasonable period thereafter).

(5) FILINGS WITH UNITED STATES.—The amendments made by this section shall not apply to any loan the aggregate principal amount of which was specified in a filing with an agency of the United States on or before June 6, 1989, if—

(A) such filing specifies such loan is to be a securities acquisition loan for purposes of section 133 of the Internal Revenue Code of 1986 and such filing is for the registration required to permit the offering of such loan, or

(B) such filing is for the approval required in order for the employee stock ownership plan to acquire more than a certain percentage of the stock of the employer.

(6) 30-PERCENT TEST SUBSTITUTED FOR 50-PERCENT TEST IN CASE OF CERTAIN LOANS.—In the case of a loan to which the amendments made by this section apply—

(A) which is made before November 18, 1989, or

(B) with respect to which such amendments would not apply if paragraph (2)(A) were applied by substituting "November 17, 1989" for "June 6, 1989" each place it appears,

section 133(b)(6)(A) of the Internal Revenue Code of 1986 (as added by subsection (a)) shall be applied by substituting "at least 30 percent" for "more than 50 percent" and section 4978B(c)(1)(B) of such Code (as added by subsection d)) shall be applied by substituting "less than 30 percent" for "50 percent or less". The preceding sentence shall apply to any loan which is used to refinance a loan described in such sentence if the requirements of subparagraphs (A), (B), and (C) of paragraph (3) are met with respect to the refinancing loan.

SEC. 7302. LIMITATIONS ON DEDUCTIONS FOR DIVIDENDS PAID ON EMPLOYER SECURITIES.

(a) IN GENERAL.—Subsection (k) of section 404 is amended to read as follows:

"(k) DEDUCTION FOR DIVIDENDS PAID ON CERTAIN EMPLOYER SECURITIES.—

"(1) GENERAL RULE.—In the case of a corporation, there shall be allowed as a deduction for a taxable year the amount of any applicable dividend paid in cash by such corporation during the taxable year with respect to applicable employer securities. Such deduction shall be in addition to the deductions allowed under subsection (a).

"(2) APPLICABLE DIVIDEND.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'applicable dividend' means any dividend which, in accordance with the plan provisions—

"(i) is paid in cash to the participants in the plan or their beneficiaries,

"(ii) is paid to the plan and is distributed in cash to participants in the plan or their beneficiaries not later than 90 days after the close of the plan year in which paid, or

"(iii) is used to make payments on a loan described in subsection (a)(9) the proceeds of which were used to acquire the employer securities (whether or not allocated to participants) with respect to which the dividend is paid.

"(B) LIMITATION ON CERTAIN DIVIDENDS.—A dividend described in subparagraph (A)(iii) which is paid with respect to any employer security which is allocated to a participant shall not be treated as an applicable dividend unless the plan provides that employer securities with a fair market value of not less than the amount of such dividend are allocated to such participant for the year which (but for subparagraph (A)) such dividend would have been allocated to such participant.

"(3) APPLICABLE EMPLOYER SECURITIES.—For purposes of this subsection, the term 'applicable employer securities' means, with respect to any dividend, employer securities which are held on the record date for such dividend by an employee stock ownership plan which is maintained by—

"(A) the corporation paying such dividend, or

"(B) any other corporation which is a member of a controlled group of corporations (within the meaning of section 409(1)(4)) which includes such corporation.

"(4) TIME FOR DEDUCTION.—

"(A) IN GENERAL.—The deduction under paragraph (1) shall be allowable in the taxable year of the corporation in which the dividend is paid or distributed to a participant or his beneficiary.

"(B) REPAYMENT OF LOANS.—In the case of an applicable dividend described in clause (iii) of paragraph (2)(A), the deduction under paragraph (1) shall be allowable in the taxable year of the corporation in which such dividend is used to repay the loan described in such clause.

"(5) OTHER RULES.—For purposes of this subsection—

"(A) DISALLOWANCE OF DEDUCTION.—The Secretary may disallow the deduction under paragraph (1) for any dividend if the Secretary determines that such dividend constitutes, in substance, an evasion of taxation.

"(B) PLAN QUALIFICATION.—A plan shall not be treated as violating the requirements of section 401, 409, or 4975(e)(7), or as engaging in a prohibited transaction for purposes of section 4975(d)(3), merely by reason of any payment or distribution described in paragraph (2)(A).

"(6) DEFINITIONS.—For purposes of this subsection—

"(A) EMPLOYER SECURITIES.—The term 'employer securities' has the meaning given such term by section 409(1).

"(B) EMPLOYEE STOCK OWNERSHIP PLAN.—The term 'employee stock ownership plan' has the meaning given such term by section 4975(e)(7). Such term includes a tax credit employee stock ownership plan (as defined in section 409)."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to employer securities acquired after August 4, 1989.

(2) SECURITIES ACQUIRED WITH CERTAIN LOANS.—The amendment made by this section shall not apply to employer securities acquired after August 4, 1989, which are acquired—

(A) with the proceeds of any loan which was made pursuant to a binding written commitment in effect on August 4, 1989, and at all times thereafter before such loan is made, and

(B) pursuant to a written binding contract (or tender offer registered with the Securities and Exchange Commission) in effect on August 4, 1989, and at all times thereafter before such securities are acquired.

SEC. 7303. 3-YEAR HOLDING PERIOD REQUIRED BEFORE SECTION 1042 SALE.

(a) IN GENERAL.—Section 1042(b) (relating to requirements to qualify for nonrecognition) is amended by adding at the end thereof the following new paragraph:

"(4) 3-YEAR HOLDING PERIOD.—The taxpayer's holding period with respect to the qualified securities is at least 3 years (determined as of the time of the sale)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to sales after July 10, 1989.

SEC. 7304. REPEAL OF CERTAIN PROVISIONS RELATING TO EMPLOYEE STOCK OWNERSHIP PLANS.

(a) ESTATE TAX DEDUCTION.—

(1) IN GENERAL.—Section 2057 (relating to sales of employer securities to employee stock ownership plans or worker-owned corporations) is hereby repealed.

(2) CONFORMING AMENDMENTS.—

(A) Paragraph (1) of section 409(n) is amended—

(i) by striking "or section 2057" each place it appears.

(ii) by striking "or any decedent if the executor of the estate of such decedent makes a qualified sale to which section 2057 applies" in subparagraph (A)(i) thereof, and

(iii) by striking "or the decedent" in subparagraph (A)(ii) thereof.

(B) Paragraphs (2)(C)(i) and (3)(A)(ii) of section 409(n) are each amended by striking "or section 2057".

(C)(i) Section 4978A is hereby repealed.

(ii) Section 4978(b)(2) is amended by striking "(determined as if such securities were disposed of in the order described in section 4978A(e))." and inserting "determined as if such securities were disposed of—

"(A) first, from section 133 securities (as defined in section 4978B(e)(2)) acquired during the 3-year period ending on the date of such disposition, beginning with the securities first so acquired.

"(B) second, from section 133 securities (as so defined) acquired before such 3-year period unless such securities (or proceeds from the disposition) have been allocated to accounts of participants or beneficiaries."

"(C) third, from qualified securities to which section 1042 applied acquired during the 3-year period ending on the date of the disposition, beginning with the securities first so acquired, and

"(D) then from any other employer securities.

If subsection (d) or section 4978B(d) applies to a disposition, the disposition shall be treated as made from employer securities in the opposite order of the preceding sentence."

(iii) The table of sections for chapter 43 is amended by striking the item relating to section 4978A.

(D) Section 4979A is amended—

(i) by striking "or section 2057" in subsection (b)(1), and

(ii) by striking "or section 2057(d)" in subsection (c)(2).

(E) The table of sections for part IV of subchapter A of chapter 11 is amended by striking the item relating to section 2057.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to the estates of decedents dying after the date of the enactment of this Act.

(b) LIABILITY FOR PAYMENT OF ESTATE TAX.—

(1) IN GENERAL.—Section 2210 (relating to liability for payment in case of transfer of employer securities) is hereby repealed.

(2) CONFORMING AMENDMENTS.—

(A) Section 2002 is amended by striking "Except as provided in section 2210, the" and inserting "The".

(B) Section 6018 is amended by striking subsection (c).

(C) The table of sections for subchapter C of chapter 11 is amended by striking the item relating to section 2210.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to estates of decedents dying after July 12, 1989.

(c) LIMITATIONS ON DEFINED CONTRIBUTION PLANS.—

(1) IN GENERAL.—Paragraph (6) of section 415(c) is amended to read as follows:

"(6) SPECIAL RULE FOR EMPLOYEE STOCK OWNERSHIP PLANS.—If no more than one-third of the employer contributions to an employee stock ownership plan (as described in section 4975(e)(7)) for a year which are deductible under paragraph (9) of section 404(a) are allocated to highly compensated employees (within the meaning of section 414(q)), the limitations imposed by this section shall not apply to—

"(A) forfeitures of employer securities (within the meaning of section 409) under such an employee stock ownership plan if

such securities were acquired with the proceeds of a loan (as described in section 404(a)(9)(A)), or

(B) employer contributions to such an employee stock ownership plan which are deductible under section 404(a)(9)(B) and charged against the participant's account."

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to years beginning after July 12, 1989.

(d) SPECIAL RULES RELATING TO NET OPERATING LOSSES.—

(1) IN GENERAL.—Section 382(1)(3) is amended by striking subparagraph (C) and by redesignating subparagraph (D) as subparagraph (C).

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to acquisitions of employer securities after July 12, 1989, except that such amendments shall not apply to acquisitions after July 12, 1989, pursuant to a written binding contract in effect on July 12, 1989, and at all times thereafter before such acquisition.

PART II—SECTION 401(H) ACCOUNTS

SEC. 7311. LIMITATION ON CONTRIBUTIONS TO SECTION 401(h) ACCOUNTS.

(a) IN GENERAL.—Section 401(h) is amended by adding at the end thereof the following new sentence: "In no event shall the requirements of paragraph (1) be treated as met if the aggregate actual contributions for medical benefits, when added to actual contributions for life insurance protection under the plan, exceed 25 percent of the total actual contributions to the plan (other than contributions to fund past service credits) after the date on which the account is established."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to contributions after October 3, 1989.

(2) TRANSITION.—The amendment made by this section shall not apply to contributions made before January 1, 1990, if—

(A) the employer requested before October 3, 1989, a private letter ruling or determination letter with respect to the qualification of the plan maintaining the account under section 401(h) of the Internal Revenue Code of 1986,

(B) the request sets forth a method under which the amount of contributions to the account are to be determined on the basis of cost,

(C) such method is permissible under section 401(h) of such Code under the provisions of General Counsel Memorandum 39785, and

(D) the Internal Revenue Service issued before October 4, 1989, a private letter ruling, determination letter, or other letter providing that the specific plan involved qualifies under section 401(a) of such Code when such method is used, that contributions to the account are deductible, or acknowledging that the account would not adversely affect the qualified status of the plan (contingent on all phases of the particular plan being approved).

Subtitle D—Foreign Provisions

SEC. 7401. TAXABLE YEAR OF CERTAIN FOREIGN CORPORATIONS.

(a) GENERAL RULE.—Subpart D of part II of subchapter N of chapter 1 (relating to miscellaneous provisions) is amended by adding at the end thereof the following new section:

"SEC. 898. TAXABLE YEAR OF CERTAIN FOREIGN CORPORATIONS.

"(a) GENERAL RULE.—For purposes of this title, the taxable year of any specified foreign corporation shall be the required year determined under subsection (c).

"(b) SPECIFIED FOREIGN CORPORATION.—For purposes of this section—

"(1) IN GENERAL.—The term 'specified foreign corporation' means any foreign corporation—

"(A) which is—

"(i) treated as a controlled foreign corporation for any purpose under subpart F of part III of this subchapter, or

"(ii) a foreign personal holding company (as defined in section 552), and

"(B) with respect to which the ownership requirements of paragraph (2) are met.

"(2) OWNERSHIP REQUIREMENTS.—

"(A) IN GENERAL.—The ownership requirements of this paragraph are met with respect to any foreign corporation if a United States shareholder owns, on each testing day, more than 50 percent of—

"(i) the total voting power of all classes of stock of such corporation entitled to vote, or

"(ii) the total value of all classes of stock of such corporation.

"(B) OWNERSHIP.—For purposes of subparagraph (A), the rules of subsections (a) and (b) of section 958 and sections 551(f) and 554, whichever are applicable, shall apply in determining ownership.

"(3) UNITED STATES SHAREHOLDER.—

"(A) IN GENERAL.—The term 'United States shareholder' has the meaning given to such term by section 951(b), except that, in the case of a foreign corporation having related person insurance income (as defined in section 953(c)(2)), the Secretary may treat any person as a United States shareholder for purposes of this section if such person is treated as a United States shareholder under section 953(c)(1).

"(B) FOREIGN PERSONAL HOLDING COMPANIES.—In the case of any foreign personal holding company (as defined in section 552) which is not a specified foreign corporation by reason of paragraph (1)(A)(i), the term 'United States shareholder' means any person who is treated as a United States shareholder under section 551.

"(c) DETERMINATION OF REQUIRED YEAR.—

"(1) CONTROLLED FOREIGN CORPORATIONS.—

"(A) IN GENERAL.—In the case of a specified foreign corporation described in subsection (b)(1)(A)(i), the required year is—

"(i) the majority U.S. shareholder year, or

"(ii) if there is no majority U.S. shareholder year, the taxable year prescribed under regulations.

"(B) 1-MONTH DEFERRAL ALLOWED.—A specified foreign corporation may elect, in lieu of the taxable year under subparagraph (A)(i), a taxable year beginning 1 month earlier than the majority U.S. shareholder year.

"(C) MAJORITY U.S. SHAREHOLDER YEAR.—

"(i) IN GENERAL.—For purposes of this subsection, the term 'majority U.S. shareholder year' means the taxable year (if any) which, on each testing day, constituted the taxable year of—

"(I) each United States shareholder described in subsection (b)(2)(A), and

"(II) each United States shareholder not described in subclause (I) whose stock was treated as owned under subsection (b)(2)(B) by any shareholder described in each subclause.

"(ii) TESTING DAY.—The testing days shall be—

"(I) the first day of the corporation's taxable year (determined without regard to this section), or

"(II) the days during such representative period as the Secretary may prescribe.

"(2) FOREIGN PERSONAL HOLDING COMPANIES.—In the case of a foreign personal holding company described in subsection (b)(3)(B), the required year shall be determined under paragraph (1), except that subparagraph (B) of paragraph (1) shall not apply."

(b) TREATMENT OF DIVIDENDS PAID AFTER CLOSE OF TAXABLE YEAR.—

(1) IN GENERAL.—Section 563 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) FOREIGN PERSONAL HOLDING COMPANY TAX.—

"(1) IN GENERAL.—In the determination of the dividends paid deduction for purposes of part III, a dividend paid after the close of any taxable year and on or before the 15th day of the 3rd month following the close of such taxable year shall, to the extent the company designates such dividend as being taken into account under this subsection, be considered as paid during such taxable year. The amount allowed as a deduction by reason of the application of this subsection with respect to any taxable year shall not exceed the undistributed foreign personal holding company income of the corporation for the taxable year computed without regard to this subsection.

"(2) SPECIAL RULES.—In the case of any distribution referred to in paragraph (1)—

"(A) paragraph (1) shall apply only if such distribution is to the person who was the shareholder of record (as of the last day of the taxable year of the foreign personal holding company) with respect to the stock for which such distribution is made,

"(B) the determination of the person required to include such distribution in gross income shall be made under the principles of section 551(f), and

"(C) any person required to include such distribution in gross or distributable net income shall include such distribution in income for such person's taxable year in which the taxable year of the foreign personal holding company ends."

(2) CONFORMING AMENDMENT.—Subsection (d) of section 563 (as redesignated by paragraph (1)) is amended by striking "subsection (a) or (b)" and inserting "subsection (a), (b), or (c)".

(c) CLERICAL AMENDMENT.—The table of sections for subpart D of part II of subchapter N of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 898. Taxable year of certain foreign corporations."

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after July 10, 1989.

(2) SPECIAL RULES.—If any foreign corporation is required by the amendments made by this section to change its taxable year for its first taxable year beginning after July 10, 1989—

(A) such change shall be treated as initiated by the taxpayer.

(B) such change shall be treated as having been made with the consent of the Secretary of the Treasury or his delegate, and

(C) if, by reason of such change, any United States person is required to include in gross income for 1 taxable year amounts attributable to 2 taxable years of such foreign corporation, the amount which would otherwise be required to be included in gross income for such 1 taxable year by reason of the short taxable year of the foreign corporation resulting from such change shall be included in gross income ratably over the 4-taxable-year period beginning with such 1 taxable year.

SEC. 7402. LIMITATION ON THE USE OF DECONSOLIDATION TO AVOID FOREIGN TAX CREDIT LIMITATIONS.

(a) GENERAL RULE.—Section 904 (relating to limitations on foreign tax credit) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) LIMITATION ON USE OF DECONSOLIDATION TO AVOID FOREIGN TAX CREDIT LIMITATIONS.—If 2 or more domestic corporations would be members of the same affiliated group if—

"(1) section 1504(b) were applied without regard to the exceptions contained therein, and

"(2) the constructive ownership rules of section 1563(e) applied for purposes of section 1504(a),

the Secretary may by regulations provide for resourcing the income of any of such corporations or for modifications to the consolidated return regulations to the extent that such resourcing or modifications are necessary to prevent the avoidance of the provisions of this subpart."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after July 10, 1989.

SEC. 7403. INFORMATION WITH RESPECT TO CERTAIN FOREIGN-OWNED CORPORATIONS.

(a) 25-PERCENT FOREIGN-OWNED CORPORATIONS REQUIRED TO REPORT.—

(1) Paragraph (2) of section 6038A(a) is amended to read as follows:

"(2) is 25-percent foreign-owned."

(2) Subsection (c) of section 6038A is amended to read as follows:

"(c) DEFINITIONS.—For purposes of this section—

"(1) 25-PERCENT FOREIGN-OWNED.—A corporation is 25-percent foreign-owned if at least 25 percent of—

"(A) the total voting power of all classes of stock of such corporation entitled to vote, or

"(B) the total value of all classes of stock of such corporation,

is owned at any time during the taxable year by 1 foreign person (hereinafter in this section referred to as a "25-percent foreign shareholder').

"(2) RELATED PARTY.—The term 'related party' means—

"(A) any 25-percent foreign shareholder of the reporting corporation,

"(B) any person who is related (within the meaning of section 267(b) or 707(b)(1)) to the reporting corporation or to a 25-percent foreign shareholder of the reporting corporation, and

"(C) any other person who is related (within the meaning of section 482) to the reporting corporation.

"(4) FOREIGN PERSON.—The term 'foreign person' means any person who is not a United States person. For purposes of the preceding sentence, the term 'United States person' has the meaning given to such term by section 7701(a)(30), except that any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States shall not be treated as a United States person.

"(5) RECORDS.—The term 'records' includes any books, papers, or other data.

"(6) SECTION 318 TO APPLY.—Section 318 shall apply for purposes of paragraphs (1) and (2), except that—

"(A) '10 percent' shall be substituted for '50 percent' in section 318(a)(2)(C), and

"(B) subparagraphs (A), (B), and (C) of section 318(a)(3) shall not be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person."

(b) U.S. RECORDKEEPING REQUIREMENTS.—Subsection (a) of section 6038A is amended by inserting before the period at the end thereof the following: "and such corporation shall maintain (in the location, in the manner, and to the extent prescribed in regulations) such records as may be appropriate to determine the correct treatment of transactions with related parties as the Secretary shall by regulations prescribe (or shall cause another person to so maintain such records)".

(c) INCREASE IN PENALTY.—Subsection (d) of section 6038A is amended to read as follows:

"(d) PENALTY FOR FAILURE TO FURNISH INFORMATION OR MAINTAIN RECORDS.—

"(1) IN GENERAL.—If a reporting corporation—

"(A) fails to furnish (within the time prescribed by regulations) any information described in subsection (b), or

"(B) fails to maintain (or cause another to maintain) records as required by subsection (a),

such corporation shall pay a penalty of $10,000 for each taxable year with respect to which such failure occurs.

"(2) INCREASE IN PENALTY WHERE FAILURE CONTINUES AFTER NOTIFICATION.—If any failure described in paragraph (1) continues for more than 90 days after the day on which the Secretary mails notice of such failure to the reporting corporation, such corporation shall pay a penalty (in addition to the amount required under paragraph (1)) of $10,000 for each 30-day period (or fraction thereof) during which such failure continues after the expiration of such 90-day period.

"(3) REASONABLE CAUSE.—For purposes of this subsection, the time prescribed by regulations to furnish information or maintain records (and the beginning of the 90-day period after notice by the Secretary) shall be treated as not earlier than the last day on which (as shown to the satisfaction of the Secretary) reasonable cause existed for failure to furnish the information or maintain the records."

(d) ENFORCEMENT OF INFORMATION REQUESTS.—Section 6038A is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) ENFORCEMENT OF REQUESTS FOR CERTAIN RECORDS.—

"(1) AGREEMENT TO TREAT CORPORATION AS AGENT.—The rules of paragraph (3) shall apply to any transaction between the reporting corporation and any related party who is a foreign person unless such related party agrees (in such manner and at such time as the Secretary shall prescribe) to authorize the reporting corporation to act as such related party's limited agent solely for purposes of applying sections 7602, 7603, and 7604 with respect to any request by the Secretary to examine records or produce testimony related to any such transaction or with respect to any summons by the Secretary for such records or testimony. The appearance of persons or production of records by reason of the reporting corporation being such an agent shall not subject such persons or records to legal process for any purpose other than determining the correct treatment under this title of any transaction between the reporting corporation and such related party.

"(2) RULES WHERE INFORMATION NOT FURNISHED.—If—

"(A) for purposes of determining the correct treatment under this title of any transaction between the reporting corporation and a related party who is a foreign person, the Secretary issues a summons to such corporation to produce (either directly or

as agent for such related party) any records or testimony.

"(B) such summons is not quashed in a proceeding begun under paragraph (4) and is not determined to be invalid in a proceeding begun under section 7604(b) to enforce such summons and,

"(C) the reporting corporation does not substantially comply in a timely manner with such summons and the Secretary has sent by certified or registered mail a notice to such reporting corporation that such reporting corporation has not so substantially complied,

the Secretary may apply the rules of paragraph (3) with respect to such transaction (whether or not the Secretary begins a proceeding to enforce such summons). If the reporting corporation fails to maintain (or cause another to maintain) records as required by subsection (a), and by reason of that failure, the summons is quashed in a proceeding described in subparagraph (B) or the reporting corporation is not able to provide the records requested in the summons, the Secretary may apply the rules of paragraph (3) with respect to any transaction to which the records relate.

"(3) APPLICABLE RULES IN CASES OF NONCOMPLIANCE.—If the rules of this paragraph apply to any transaction—

"(A) the amount of the deduction allowed under subtitle A for any amount paid or incurred by the reporting corporation to the related party in connection with such transaction, and

"(B) the cost to the reporting corporation of any property acquired in such transaction from the related party (or transferred by such corporation in such transaction to the related party),

shall be the amount determined by the Secretary in the Secretary's sole discretion from the Secretary's own knowledge or from such information as the Secretary may obtain through testimony or otherwise.

"(4) JUDICIAL PROCEEDINGS.—

"(A) PROCEEDINGS TO QUASH.—Notwithstanding any law or rule of law, any reporting corporation to which the Secretary issues a summons referred to in paragraph (2)(A) shall have the right to begin a proceeding to quash such summons not later than the 90th day after such summons was issued. In any such proceeding, the Secretary may seek to compel compliance with such summons.

"(B) REVIEW OF SECRETARIAL DETERMINATION OF NONCOMPLIANCE.—Notwithstanding any law or rule of law, any reporting corporation which has been notified by the Secretary that the Secretary has determined that such corporation has not substantially complied with a summons referred to in paragraph (2) shall have the right to begin a proceeding to review such determination not later than the 90th day after the day on which the notice referred to in paragraph (2)(C) was mailed. If such a proceeding is not begun on or before such 90th day, such determination by the Secretary shall be binding and shall not be reviewed by any court.

"(C) JURISDICTION.—The United States district court for the district in which the person (to whom the summons is issued) resides or is found shall have jurisdiction to hear any proceeding brought under subparagraph (A) or (B). Any order or other determination in such a proceeding shall be treated as a final order which may be appealed.

"(D) SUSPENSION OF STATUTE OF LIMITATIONS.—If the reporting corporation brings an action under subparagraph (A) or (B), the running of any period of limitations under section 6501 (relating to assessment and collection of tax) or under section 6531 (relating to criminal prosecutions) with respect to any transaction to which the summons relates shall be suspended for the period during which such proceeding, and appeals therein, are pending. In no event shall any such period expire before the 90th day after the day on which there is a final determination in such proceeding."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after July 10, 1989.

SEC. 7404. REPEAL OF SPECIAL TREATMENT OF INTEREST ON CERTAIN FOREIGN LOANS.

(a) GENERAL RULE.—Paragraph (2) of section 1201(e) of the Tax Reform Act of 1986 is hereby repealed.

(b) EFFECTIVE DATE.—The repeal made by subsection (a) shall apply to taxable years beginning after December 31, 1989.

(c) EXCEPTION FOR CERTAIN TAXPAYERS WITH SUBSTANTIAL LOAN LOSS RESERVES.—

(1) IN GENERAL.—The repeal made by subsection (a) shall not apply to any taxpayer if, on any financial statement filed by such taxpayer for regulatory purposes with respect to any quarter ending during the period beginning on March 31, 1989, and ending on December 31, 1989, such taxpayer showed loss reserves against its qualified loans equal to at least 25 percent of the amount of such loans.

(2) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

(A) QUALIFIED LOAN.—The term "qualified loan" has the meaning given such term by section 1201(e)(2)(H) of the Tax Reform Act of 1986 (as in effect before its repeal by subsection (a)).

(B) PARENT-SUBSIDIARY CONTROLLED GROUPS.—In the case of any taxpayer which is a member of a parent-subsidiary controlled group (as defined in section 585(c)(5)(A)), this subsection shall be applied by treating all members of such group as 1 taxpayer.

Subtitle E—Excise Tax Provisions

SEC. 7501. 1-YEAR SUSPENSION OF AUTOMATIC REDUCTION IN AVIATION-RELATED TAXES.

(a) IN GENERAL.—Subsection (a) of section 4283 (relating to reduction in aviation-related taxes in certain cases) is amended by striking "1990" and inserting "1991".

(b) CONFORMING AMENDMENTS.—

(1) Clause (i) of section 4283(b)(1)(A) is amended by striking "1988 and 1989" and inserting "1989 and 1990".

(2) Paragraph (3) of section 4283(b) is amended—

(A) by striking "1990" and inserting "1991", and

(B) by striking "1989" and inserting "1990".

(3) Subsection (q) of section 6427 is amended by striking "1990" each place it appears and inserting "1991".

SEC. 7502. ACCELERATION OF DEPOSIT REQUIREMENTS FOR AIRLINE TICKET TAX.

(a) IN GENERAL.—Section 6302 (relating to mode or time of collection) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) TIME FOR DEPOSIT OF TAXES ON AIRLINE TICKETS.—If, under regulations prescribed by the Secretary, a person is required to make deposits of any tax imposed by subsection (a) or (b) of section 4261 with respect to amounts considered collected by such person during any semimonthly period, such deposit shall be made not later than the 3rd day (not including Saturdays, Sundays, or legal holidays) after the close of the 1st week of the 2nd semimonthly period following the period to which such amounts relate."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to payments of taxes considered collected for semi-monthly periods beginning after June 30, 1990.

SEC. 7503. INCREASE IN INTERNATIONAL AIR PASSENGER DEPARTURE TAX.

(a) IN GENERAL.—Section 4261(c) (relating to tax on use of international travel facilities) is amended by striking "$3" and inserting "$6".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to transportation beginning after December 31, 1989, which was not paid for before such date.

SEC. 7504. SHIP PASSENGERS INTERNATIONAL DEPARTURE TAX.

(a) IN GENERAL.—Chapter 36 (relating to certain other excise taxes) is amended by inserting after subchapter A the following new subchapter.

"Subchapter B—Transportation by Water

"Sec. 4471. Imposition of tax.
"Sec. 4472. Definitions and special rules.

"SEC. 4471. IMPOSITION OF TAX.

"(a) IN GENERAL.—There is hereby imposed a tax of $3 per passenger on a covered voyage.

"(b) BY WHOM PAID.—The tax imposed by this section shall be paid by the person providing the covered voyage.

"(c) TIME OF IMPOSITION.—The tax imposed by this section shall be imposed only once for each passenger on a covered voyage, either at the time of first embarkation or disembarkation in the United States.

"SEC. 4472. DEFINITIONS.

"For purposes of this subchapter—

"(1) COVERED VOYAGE.—

"(A) IN GENERAL.—The term 'covered voyage' means a voyage of—

"(i) a commercial passenger vessel which extends over 1 or more nights, or

"(ii) a commercial vessel transporting passengers engaged in gambling aboard the vessel beyond the territorial waters of the United States.

during which passengers embark or disembark the vessel in the United States. Such term shall not include any voyage on any vessel owned or operated by the United States, a State, or any agency or subdivision thereof.

"(B) EXCEPTION FOR CERTAIN VOYAGES ON PASSENGER VESSELS.—The term 'covered voyage' shall not include a voyage of a passenger vessel of less than 12 hours between 2 ports in the United States.

"(2) PASSENGER VESSEL.—The term 'passenger vessel' means any vessel having berth or stateroom accommodations for more than 16 passengers."

(b) CLERICAL AMENDMENTS.—The table of subchapters for chapter 36 is amended by inserting after the item relating to subchapter A the following new item:

"SUBCHAPTER B. Transportation by water."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to voyages beginning after December 31, 1989, which were not paid for before such date.

(2) NO DEPOSITS REQUIRED BEFORE APRIL 1, 1990.—No deposit of any tax imposed by subchapter B of chapter 36 of the Internal Revenue Code of 1986, as added by this section, shall be required to be made before April 1, 1990.

SEC. 7505. OIL SPILL LIABILITY TRUST FUND TAX TO TAKE EFFECT ON JANUARY 1, 1990.

(a) TAX TO TAKE EFFECT ON JANUARY 1, 1990.—

(1) IN GENERAL.—Subsection (f) of section 4611 (relating to application of Oil Spill Liability Trust Fund financing rate) is amended to read as follows:

"(f) APPLICATION OF OIL SPILL LIABILITY TRUST FUND FINANCING RATE.—

"(1) IN GENERAL.—Except as provided in paragraph (2), the Oil Spill Liability Trust Fund financing rate under subsection (c) shall apply after December 31, 1989, and before January 1, 1995.

"(2) NO TAX IF UNOBLIGATED BALANCE IN FUND EXCEEDS $1,000,000,000.—The Oil Spill Liability Trust Fund financing rate shall not apply during any calendar quarter if the Secretary estimates that as of the close of the preceding calendar quarter the unobligated balance in the Oil Spill Liability Trust Fund exceeds $1,000,000,000."

(b) 5 CENT RATE OF TAX.—Subparagraph (B) of section 4611(c)(2) is amended by striking "1.3 cents" and inserting "5 cents".

(c) CREDIT AGAINST OIL SPILL TAX FOR EXCESS AMOUNTS IN THE TRANS-ALASKA PIPELINE LIABILITY FUND.—Subsection (d) of section 4612 is amended by adding at the end thereof the following new sentence:

The preceding sentence shall also apply to amounts paid by the taxpayer into the Trans-Alaska Pipeline Liability Fund to the extent of amounts transferred from such Fund into the Oil Spill Liability Trust Fund. Amounts may be transferred from the Trans-Alaska Pipeline Liability Fund

into the Oil Spill Liability Trust Fund only to the extent the administrators of the Trans-Alaska Pipeline Liability Fund determine that such amounts are not needed to satisfy claims against such Fund."

(d) OIL SPILL LIABILITY TRUST FUND TO BE OPERATING FUND.—

(1) IN GENERAL.—For purposes of sections 8032(d) and 8033(c) of the Omnibus Budget Reconciliation Act of 1986, the commencement date is January 1, 1990.

(2) CONFORMING AMENDMENTS.—

(A) Section 9509 (relating to Oil Spill Liability Trust Fund) is amended by adding at the end thereof the following new subsection:

"(f) REFERENCES TO COMPREHENSIVE OIL POLLUTION LIABILITY AND COMPENSATION ACT.—For purposes of this section, references to the Comprehensive Oil Pollution Liability and Compensation Act shall be treated as references to any law enacted before December 31, 1990, which is substantially identical to subtitle E of title VI, or subtitle D of title VIII, of H.R. 5300 of the 99th Congress as passed by the House of Representatives."

(B) Paragraph (3) of section 9509(b) is amended by striking "(on the 1st day the Oil Spill Liability Trust Fund financing rate under section 4611(c) applies)" and inserting "(on January 1, 1990)".

(C) Paragraph (1) of section 9509(c) is amended by striking the last sentence.

SEC. 7506. EXCISE TAX ON SALE OF CHEMICALS WHICH DEPLETE THE OZONE LAYER AND OF PRODUCTS CONTAINING SUCH CHEMICALS.

(a) IN GENERAL.—Chapter 38 (relating to environmental taxes) is amended by adding at the end thereof the following new subchapter:

"Subchapter D—Ozone-Depleting Chemicals, Etc.

"Sec. 4681. Imposition of tax.
"Sec. 4682. Definitions and special rules.

"SEC. 4681. IMPOSITION OF TAX.

"(a) GENERAL RULE.—There is hereby imposed a tax on—

"(1) any ozone-depleting chemical sold or used by the manufacturer, producer, or importer thereof, and

"(2) any imported taxable product sold or used by the importer thereof.

"(b) AMOUNT OF TAX.—

"(1) OZONE-DEPLETING CHEMICALS.—

"(A) IN GENERAL.—The amount of the tax imposed by subsection (a) on each pound of ozone-depleting chemical shall be an amount equal to—

"(i) the base tax amount, multipled by

"(ii) the ozone-depletion factor for such chemical.

"(B) BASE TAX AMOUNT FOR YEARS BEFORE 1995.—The base tax amount for purposes of subparagraph (A) with respect to any sale or use during a calendar year before 1995 is the amount determined under the following table for such calendar year:

"Calendar year:	Base tax amount
1990 or 1991	$1.37
1992	1.67
1993 or 1994	2.65.

"(C) BASE TAX AMOUNT FOR YEARS AFTER 1994.—The base tax amount for purposes of subparagraph (A) with respect to any sale or use during a calendar year after 1994 shall be the base tax amount for 1994 increased by 45 cents for each year after 1994.

"(2) IMPORTED TAXABLE PRODUCT.—

"(A) IN GENERAL.—The amount of the tax imposed by subsection (a) on any imported taxable product shall be the amount of tax which would have been imposed by subsection (a) on the ozone-depleting chemicals used as materials in the manufacture or production of such product if such ozone-depleting chemicals had been sold in the United States on the date of the sale of such imported taxable product.

"(B) CERTAIN RULES TO APPLY.—Rules similar to the rules of paragraphs (2) and (3) of section 4671(b) shall apply.

"SEC. 4682. DEFINITIONS AND SPECIAL RULES.

"(a) OZONE-DEPLETING CHEMICAL.—For purposes of this subchapter—

"(1) IN GENERAL.—The term 'ozone-depleting chemical' means any substance—

"(A) which, at the time of the sale or use by the manufacturer, producer, or importer, is listed as an ozone-depleting chemical in the table contained in paragraph (2), and

"(B) which is manufactured or produced in the United States or entered into the United States for consumption, use, or warehousing.

"(2) OZONE-DEPLETING CHEMICALS.—

"Common name:	Chemical nomenclature:
CFC-11	trichlorofluoromethane
CFC-12	dichlorodifluoromethane
CFC-113	trichlorotrifluoroethane
CFC-114	1,2-dichloro-1,1,2,2-tetra-fluoroethane
CFC-115	chloropentafluoroethane
Halon-1211	bromochlorodifluoromethane
Halon-1301	bromotrifluoromethane
Halon-2402	dibromotetrafluoroethane.

"(b) OZONE-DEPLETION FACTOR.—For purposes of this subchapter, the term 'ozone-depletion factor' means, with respect to an ozone-depleting chemical, the factor assigned to such chemical under the following table:

"Ozone-depleting chemical:	Ozone-depletion factor:
CFC-11	1.0
CFC-12	1.0
CFC-113	0.8
CFC-114	1.0
CFC-115	0.6
Halon-1211	3.0
Halon-1301	10.0
Halon-2402	6.0.

"(c) IMPORTED TAXABLE PRODUCT.—For purposes of this subchapter—

"(1) IN GENERAL.—The term 'imported taxable product' means any product (other than an ozone-depleting chemical) entered into the United States for consumption, use, or warehousing if any ozone-depleting chemical was used as material in the manufacture or production of such product.

"(2) DE MINIMIS EXCEPTION.—The term 'imported taxable product' shall not include any product specified in regulations prescribed by the Secretary as using a de minimis amount of ozone-depleting chemicals as materials in the manufacture or production thereof. The preceding sentence shall not apply to any product in which any ozone-depleting chemical is used for purposes of refrigeration or air conditioning, creating an aerosol or foam, or manufacturing electronic components.

"(d) EXCEPTIONS.—

"(1) RECYCLING.—No tax shall be imposed by section 4681 on any ozone-depleting chemical which is diverted or recovered in the United States as part of a recycling process (and not as part of the original manufacturing or production process).

"(2) USE IN FURTHER MANUFACTURE.—

"(A) IN GENERAL.—No tax shall be imposed by section 4681—

"(i) on the use of any ozone-depleting chemical in the manufacture or production of any other chemical if the ozone-depleting chemical is entirely consumed in such use.

"(ii) on the sale by the manufacturer, producer, or importer of any ozone-depleting chemical—

"(I) for a use by the purchaser which meets the requirements of clause (i), or

"(II) for resale by the purchaser to a second purchaser for a use by the second purchaser which meets the requirements of clause (i).

Clause (ii) shall apply only if the manufacturer, producer, and importer, and the 1st and 2d purchasers (if any), meet such registration requirements as may be prescribed by the Secretary.

"(B) CREDIT OR REFUND.—Under regulations prescribed by the Secretary, if—

"(i) a tax under this subchapter was paid with respect to any ozone-depleting chemical, and

"(ii) such chemical was used (and entirely consumed) by any person in the manufacture or production of any other chemical,

then an amount equal to the tax so paid shall be allowed as a credit or refund (without interest) to such person in the same manner as if it were an overpayment of tax imposed by section 4681.

"(3) EXPORTS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), rules similar to the rules of section 4622(e) (other than section 4662(e)(2)(A)(ii)(II)) shall apply for purposes of this subchapter.

"(B) LIMIT ON BENEFIT.—

"(i) IN GENERAL.—The aggregate tax benefit allowable under subparagraph (A) with respect to ozone-depleting chemicals manufactured or produced by any person during a calendar year shall not exceed the sum of—

"(I) the amount equal to the 1986 export percentage of the aggregate tax imposed by this subchapter with respect to ozone-depleting chemicals manufactured or produced by such person during such calendar year (other than chemicals with respect to which subclause (II) applies), and

"(II) the aggregate tax imposed by this subchapter with respect to any additional production allowance granted to such person with respect to ozone-depleting chemicals manufactured or produced by such person during such calendar year by the Environmental Protection Agency under 40 CFR Part 82 (as in effect on September 14, 1989).

"(ii) 1986 EXPORT PERCENTAGE.—A person's 1986 export percentage is the percentage equal to the ozone-depletion factor adjusted pounds of ozone-depleting chemicals manufactured or produced by such person during 1986 which were exported during 1986, divided by ozone-depletion factor adjusted pounds of all ozone-depleting chemicals manufactured or produced by such person during 1986. The percentage determined under the preceding sentence shall be based on data published by the Environmental Protection Agency.

"(e) OTHER DEFINITIONS.—For purposes of this subchapter—

"(1) IMPORTER.—The term 'importer' means the person entering the article for consumption, use, or warehousing.

"(2) UNITED STATES.—The term 'United States' has the meaning given such term by section 4612(a)(4).

"(f) SPECIAL RULES.—

"(1) FRACTIONAL PARTS OF A POUND.—In the case of a fraction of a pound, the tax imposed by this subchapter shall be the same fraction of the amount of such tax imposed on a whole pound.

"(2) DISPOSITION OF REVENUES FROM PUERTO RICO AND THE VIRGIN ISLANDS.—The provisions of subsections (a)(3) and (b)(3) of section 7652 shall not apply to any tax imposed by this subchapter.

"(g) PHASE-IN OF TAX ON CERTAIN SUBSTANCES.—

"(1) TREATMENT FOR 1990.—

"(A) HALONS.—The term 'ozone-depleting chemical shall not include halon-1211, halon-1301, or halon-2402 with respect to any sale or use during 1990.

"(B) CHEMICALS USED IN RIGID FOAM INSULATION.—No tax shall be imposed by section 4681—

"(i) on the use during 1990 of any substance in the manufacture of rigid foam insulation,

"(ii) on the sale during 1990 by the manufacturer, producer, or importer of any substance—

"(I) for use by the purchaser in the manufacture of rigid foam insulation, or

"(II) for resale by the purchaser to a second purchaser for such use by the second purchaser, or

"(iii) on the sale or use during 1990 by the importer of any rigid foam insulation.

Clause (ii) shall apply only if the manufacturer, producer, and importer, and the 1st and 2d purchasers (if any) meet such registration requirements as may be prescribed by the Secretary.

"(2) TREATMENT FOR 1991, 1992, AND 1993.—

"(A) HALONS.—The tax imposed by section 4681 during 1991, 1992, or 1993 by reason of the treatment of halon-1211, halon-1301, and halon-2402 as ozone-depleting chemicals shall be the applicable percentage (determined under the following table) of the amount of such tax which would (but for this subparagraph) be imposed.

"In the case of:	The applicable percentage is: For sales or use during 1991	For sales or use during 1992	For sales or use during 1993
Halon-1211	6.0	5.0	3.3
Halon-1301	1.8	1.5	1.0
Halon-2402	3.0	2.5	1.6.

"(B) CHEMICALS USED IN RIGID FOAM INSULATION.—In the case of a sale or use during 1991, 1992, or 1993 on which no tax would have been imposed by reason of paragraph (1)(B) had such sale or use occurred during 1990, the tax imposed by section 4681 shall be the applicable percentage (determined in accordance with the following table) of the amount of such tax which would (but for this subparagraph) be imposed.

"In the case of sales or use during:	The applicable percentage is:
1991	18
1992	15
1993	10.

"(3) OVERPAYMENTS WITH RESPECT TO CHEMICALS USED IN RIGID FOAM INSULATION.—If any substance on which tax was paid under this subchapter is used during 1990, 1991, 1992, or 1993 by any person in the manufacture of rigid foam insulation, credit or refund (without interest) shall be allowed to such person an amount equal to the excess of—

"(A) the tax paid under this subchapter on such substance, over

"(B) the tax (if any) which would be imposed by section 4681 if such substance were used for such use by the manufacturer, producer, or importer thereof on the date of its use by such person.

"Amounts payable under the preceding sentence with respect to uses during the taxable year shall be treated as described in section 34(a) for such year unless claim therefor has been timely filed under this paragraph.

"(h) IMPOSITION OF FLOOR STOCKS TAXES.—

"(1) JANUARY 1, 1990, TAX.—On any ozone-depleting chemical which on January 1, 1990, is held by any person (other than the manufacturer, producer, or importer thereof) for sale or for use in further manufacture, there is hereby imposed a floor stocks tax in an amount equal to the tax which would be imposed by manufacturer, producer, or importer thereof had occurred during 1990.

"(2) OTHER TAX-INCREASE DATES.—

"(A) IN GENERAL.—If, on any tax-increase date, any ozone-depleting chemical is held by any person (other than the manufacturer, producer, or importer thereof) for sale or for use in further manufacture, there is hereby imposed a floor stocks tax.

"(B) AMOUNT OF TAX.—The amount of the tax imposed by subparagraph (A) shall be the excess (if any) of—

"(i) the tax which would be imposed under section 4681 on such substance if the sale of such chemical by the manufacturer, producer, or importer thereof had occurred on the tax-increase date, over

"(ii) the prior tax (if any) imposed by this subchapter on such substance.

"(C) TAX-INCREASE DATE.—For purposes of this paragraph, the term 'tax-increase date' means January 1 of 1991, 1992, 1993, and 1994.

"(3) DUE DATE.—The taxes imposed by this subsection on January 1 of any calendar year shall be paid on or before April 1 of such year.

"(4) APPLICATION OF OTHER LAWS.—All other provisions of law, including penalties, applicable with respect to the taxes imposed by section 4681 shall apply to the floor stocks taxes imposed by this subsection."

(b) CLERICAL AMENDMENT.—The table of subchapters for chapter 38 is amended by adding at the end thereof the following new item:

"SUBCHAPTER D. Ozone-depleting chemicals, etc."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall take effect on January 1, 1990.

(2) NO DEPOSITS REQUIRED BEFORE APRIL 1, 1990.—No deposit of any tax imposed by subchapter D of chapter 38 of the Internal Revenue Code of 1986, as added by this section, shall be required to be made before April 1, 1990.

(3) NOTIFICATION OF CHANGES IN INTERNATIONAL AGREEMENTS.—The Secretary of the Treasury or his delegate shall notify the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate on changes in the Montreal Protocol and of other international

agreements to which the United States is a signatory relating to ozone-depleting chemicals.

SEC. 7507. ACCELERATION OF DEPOSIT REQUIREMENTS FOR GASOLINE EXCISE TAX.

(a) IN GENERAL.—Section 6302 (relating to mode or time of collection), as amended by section 7502, is amended by redesignating subsection(f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) TIME FOR DEPOSIT OF TAXES ON GASOLINE.—

"(1) GENERAL RULE.—Notwithstanding section 518 of the Highway Revenue Act of 1982, any person whose liability for tax under section 4081 is payable with respect to semimonthly periods shall, not later than September 27, make deposits of such tax for the period beginning on September 16 and ending on September 22.

"(2) SPECIAL RULE WHERE DUE DATE FALLS ON SATURDAY, SUNDAY, OR HOLIDAY.—If, but for this paragraph, the due date under paragraph (1) would fall on a Saturday, Sunday, or holiday in the District of Columbia, such due date shall be deemed to be the immediately preceding day which is not a Saturday, Sunday, or such a holiday."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to payments of taxes for tax periods beginning after December 31, 1989.

SEC. 7508. TAXATION OF BULK CIGAR IMPORTS.

(a) IN GENERAL.—Subsection (c) of section 5704 (relating to tobacco products and cigarette papers and tubes released in bond from customs custody) is amended by inserting "or to a manufacturer of tobacco products or cigarette papers and tubes if such articles are not put up in packages," after "export warehouse,".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to articles imported or brought into the United States after the date of the enactment of this Act.

Subtitle F—Miscellaneous Provisions

PART I—LIMITATION ON NONRECOGNITION FOR CERTAIN EXCHANGES

SEC. 7601. LIKE KIND EXCHANGES BETWEEN RELATED PERSONS.

(a) SPECIAL RULES FOR EXCHANGES BETWEEN RELATED PERSONS, ETC.—Section 1031 (relating to exchange of property held for productive use or investment) is amended by adding at the end thereof the following new subsections:

"(f) SPECIAL RULES FOR EXCHANGES BETWEEN RELATED PERSONS.—

"(1) IN GENERAL.—If—

"(A) a taxpayer exchanges property with a related person.

"(B) there is nonrecognition of gain or loss to the taxpayer under this section with respect to the exchange of such property (determined without regard to this subsection), and

"(C) before the date 2 years after the date of the last transfer which was part of such exchange—

"(i) the related person disposes of such property, or

"(ii) the taxpayer disposes of the property received in the exchange from the related person which was of like kind to the property transferred by the taxpayer,

there shall be no nonrecognition of gain or loss under this section to the taxpayer with respect to such exchange; except that any gain or loss recognized by the taxpayer by reason of this subsection shall be taken into account as of the date on which the disposition referred to in subparagraph (C) occurs.

"(2) CERTAIN DISPOSITIONS NOT TAKEN INTO ACCOUNT.—For purposes of paragraph (1)(C), there shall not be taken into account any disposition—

"(A) after the earlier of the death of the taxpayer or the death of the related person,

"(B) in a compulsory or involuntary conversion (within the meaning of section 1033) if the exchange occurred before the threat or imminence of such conversion, or

"(C) with respect to which it is established to the satisfaction of the Secretary that neither the exchange nor such disposition had as one of its principal purposes the avoidance of Federal income tax.

"(3) RELATED PERSON.—For purposes of this subsection, the term 'related person' means any person bearing a relationship to the taxpayer described in section 267(b).

"(4) TREATMENT OF CERTAIN TRANSACTIONS.—This section shall not apply to any exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection.

"(g) SPECIAL RULE WHERE SUBSTANTIAL DIMINUTION OF RISK.—

"(1) IN GENERAL.—If paragraph (2) applies to any property for any period, the running of the period set forth in subsection (f)(1)(C) with respect to such property shall be suspended during such period.

"(2) PROPERTY TO WHICH SUBSECTION APPLIES.—This paragraph shall apply to any property for any period during which the holder's risk of loss with respect to the property is substantially diminished by—

"(A) the holding of a put with respect to such property,

"(B) the holding by another person of a right to acquire such property, or

"(C) a short sale or any other transaction.

"(h) SPECIAL RULE FOR FOREIGN REAL PROPERTY.—For purposes of this section, real property located in the United States and real property located outside the United States are not property of a like kind."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to transfers after July 10, 1989, in taxable years ending after such date.

(2) BINDING CONTRACT.—The amendments made by this section shall not apply to any transfer pursuant to a written binding contract in effect on July 10, 1989, and at all times thereafter before the transfer.

PART II—MINIMUM TAX PROVISIONS

SEC. 7611. SIMPLIFICATION OF ADJUSTED CURRENT EARNINGS PREFERENCE.

(a) ELIMINATION OF BOOK LIMITATIONS APPLICABLE TO DEPRECIATION.—

(1) IN GENERAL.—

(A) Clause (i) of section 56(g)(4)(A) (relating to depreciation) is amended to read as follows:

"(i) PROPERTY PLACED IN SERVICE AFTER 1989.—The depreciation deduction with respect to any property placed in service in a taxable year beginning after 1989 shall be determined under the alternative system of section 168(g)."

(B) Subparagraph (A) of section 56(g)(4) is amended by striking clauses (v) and (vi) and by redesignating clause (vii) as clause (v).

(2) TECHNICAL AMENDMENT.—Clause (iii) of section 56(g)(4)(A) is amended by inserting "and which is placed in service in a taxable year beginning before 1990" after "thereof) applies".

(b) TREATMENT OF CERTAIN EARNINGS AND PROFITS ADJUSTMENTS.—Subparagraph (D) of section 56(g)(4) is amended to read as follows:

"(D) CERTAIN OTHER EARNINGS AND PROFITS ADJUSTMENTS.—

"(i) INTANGIBLE DRILLING COSTS.—The adjustments provided in section 312(n)(2)(A) shall apply in the case of amounts paid or incurred in taxable years beginning after December 31, 1989.

"(ii) CERTAIN AMORTIZATION PROVISIONS NOT TO APPLY.—Sections 173 and 248 shall not apply to expenditures paid or incurred in taxable year beginning after December 31, 1989.

"(iii) LIFO INVENTORY ADJUSTMENTS.—The adjustments provided in section 312(n)(4) shall apply.

"(iv) INSTALLMENT SALES.—In the case of any installment sale in a taxable year beginning after December 31, 1989, adjusted current earnings shall be computed as if the corporation did not use the installment method. The preceding sentence shall not apply to the applicable percentage (as determined under section 453A) of the gain from any installment sale with respect to which section 453(a)(1) applies."

(c) ELIMINATION OF BOOK LIMITATION ON DEPLETION.—Subparagraph (G) of section 56(g)(4) is amended to read as follows:

"(G) DEPLETION.—The allowance for depletion with respect to any property placed in service in a taxable year beginning after 1989 shall be cost depletion determined under section 611."

(d) TREATMENT OF CERTAIN DIVIDENDS.—Clause (ii) of section 56(g)(4)(C) is amended to read as follows:

"(ii) SPECIAL RULE FOR CERTAIN DIVIDENDS.—

"(I) IN GENERAL.—Clause (i) shall not apply to any deduction allowable under section 243 or 245 for any dividend which is a 100-percent dividend or which is received from a 20-percent owned corporation (as defined in section 243(c)(2)), but only to the extent such dividend is attributable to income of the paying corporation which is subject to tax under this chapter (determined after the application of sections 936 and 921).

"(II) 100-PERCENT DIVIDEND.—For purposes of the subclause (I), the term '100 percent dividend' means any dividend if the percentage used for purposes of determining the amount allowable as a deduction under section 243 or 245 with respect to such dividend is 100 percent."

(e) SPECIAL RULE FOR CERTAIN DIVIDENDS RECEIVED BY COOPERATIVES.—Subparagraph (C) of section 56(g)(4) is amended by adding at the end thereof the following new clause:

"(iv) SPECIAL RULE FOR CERTAIN DIVIDENDS RECEIVED BY CERTAIN COOPERATIVES.—In the case of a cooperative described in section 927(a)(4), clause (i) shall not apply to any amount allowable as a deduction under section 245(c)."

(f) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Clause (i) of section 56(g)(4)(H) is amended by striking after the date of the enactment of the Tax Reform Act of 1986" and inserting "in a taxable year beginning after 1989".

(2) Clause (i) of section 56(g)(4)(B) is amended by adding at the end thereof the following new sentence:

"The preceding sentence shall not apply in the case of any amount excluded from gross income under section 108 (or the corresponding provisions of prior law)."

(3) Clause (iii) of section 56(g)(4)(B) is hereby repealed.

(4) Paragraph (5) of section 56(g) is amended by striking subparagraphs (A) and (C) and by redesignating subparagraphs (B) and (D) as subparagraphs (A) and (B), respectively.

(5)(A) Clause (ii) of section 312(n)(2)(A) is amended by striking "in which the production from the well begins" and inserting "in which such amount was paid or incurred".

(B) Paragraph (1) of section 59(e) is amended by inserting before the period at the end thereof: "(or, in the case of a qualified expenditure described in paragraph (2)(C), over the 60-month period beginning with the month in which such expenditure was paid or incurred)".

(6) Subsection (i) of section 59 is amended—

(A) by striking "interest shall" and inserting "any amount shall", and

(B) by striking "INTEREST" in the subsection heading and inserting "AMOUNTS".

(g) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 1989.

(2) INTANGIBLE DRILLING COSTS.—The amendments made by subsection (f)(5) shall apply to costs paid or incurred in taxable years beginning after December 31, 1989.

(3) REGULATIONS ON EARNINGS AND PROFITS RULES.—Not later than March 15, 1991, the Secretary of the Treasury or his delegate shall prescribe initial regulations providing guidance as to which items of income are included in adjusted current earnings under section 56(g)(4)(B)(i) of the Internal Revenue Code of 1986 and which items of deduction are disallowed under section 56(g)(4)(C) of such Code.

SEC. 7612. OTHER MODIFICATIONS TO MINIMUM TAX.

(a) MODIFICATION TO CORPORATE MINIMUM TAX CREDIT.—

(1) IN GENERAL.—Subparagraph (B) of section 53(d)(1) (relating to credit not allowed for exclusion preferences) is amended by adding at the end thereof the following new clause:

"(iv) CREDIT ALLOWABLE FOR EXCLUSION PREFERENCES OF CORPORATIONS.—In the case of a corporation—

"(I) the preceding provisions of this subparagraph shall not apply, and

"(II) the adjusted net minimum tax for any taxable year is the amount of the net minimum tax for such year increased by the amount of any credit not allowed under section 29 solely by reason of the application of section 29(b)(5)(B)."

(2) CONFORMING AMENDMENT.—Clause (ii) of section 53(d)(1)(B) is amended—

(A) by striking "subsections (b)(1) and (c)(3)" and inserting "subsection (b)(1)", and

(B) by striking the last sentence.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply for purposes of determining the adjusted net minimum tax for taxable years beginning after December 31, 1989.

(b) ADJUSTMENT FOR DISALLOWED PORTION OF ORPHAN DRUG CREDIT.—

(1) IN GENERAL.—Clauses (iii) and (iv) of section 53(d)(1)(B) (as amended by subsection (a)) are each amended by inserting after "section 29(d)(5)(B)" the following: "or not allowed under section 28 solely by reason of the application of section 28(d)(2)(B)".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply for purposes of determining the amount of the minimum tax credit for taxable years beginning after December 31, 1989; except that, for such purposes, section 53(b)(1) of the Internal Revenue Code of 1986 shall be applied as if such amendment had been in effect for all prior taxable years.

(c) EXEMPTION FOR CERTAIN HOME CONSTRUCTION CONTRACTS.—

(1) IN GENERAL.—Paragraph (3) of section 56(a) (relating to treatment of certain long-term contracts) is amended by striking "with respect to which the requirements of clauses (i) and (ii) of section 460(e)(1)(B) are met".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to contracts entered into in taxable years beginning after September 30, 1990.

(d) TREATMENT OF CERTAIN RESEARCH AND EXPERIMENTAL EXPENDITURES.—

(1) IN GENERAL.—Paragraph (2) of section 56(b) (relating to circulation and research and experimental expenditures) is amended by adding at the end thereof the following new subparagraph:

"(D) EXCEPTION FOR CERTAIN RESEARCH AND EXPERIMENTAL EXPENDITURES.—If the taxpayer materially participates (within the meaning of section 469(h)) in an activity, this paragraph shall not apply to any amount allowable as a deduction under section 174(a) for expenditures paid or incurred in connection with such activity."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to taxable years beginning after December 31, 1990.

(e) 90-PERCENT LIMITATION ON FOREIGN TAX CREDIT NOT TO APPLY TO CERTAIN CORPORATIONS.—

(1) IN GENERAL.—Paragraph (2) of section 59(a) (relating to limitation of foreign tax credit to 90-percent of tax) is amended by adding at the end thereof the following new subparagraph:

"(C) EXCEPTION.—Subparagraph (A) shall not apply to any domestic corporation if—

"(i) more than 50 percent of the stock of such domestic corporation (by vote and value) is owned by United States persons who are not members of an affiliated group (as defined in section 1504 of such Code) which includes such corporation,

"(ii) all of the activities of such corporation are conducted in 1 foreign country with which the United States has an income tax treaty in effect and such treaty provides for the exchange of information between such foreign country and the United States,

"(iii) all of the current earnings and profits of such corporation are distributed at least annually (other than current earnings and profits retained for normal maintenance or capital replacements or improvements of an existing business), and

"(iv) all such distributions by such corporation to United States persons are used by such persons in a trade or business conducted in the United States."

(2) EFFECTIVE DATE.—

(A) IN GENERAL.—The amendment made by paragraph (1) shall apply to taxable years beginning after March 31, 1990.

(B) SPECIAL RULE FOR YEAR WHICH INCLUDES MARCH 31, 1990.—In the case of any taxable year (of a corporation described in subparagraph (C) of section 59(a)(2) of the Internal Revenue Code of 1986 (as added by paragraph (1))) which begins after December 31, 1989, and includes March 31, 1990, the amount determined under clause (ii) of section 59(a)(2)(A) of such Code shall be an amount which bears the same ratio to the amount which would have been determined under such clause without regard to this subparagraph as the number of days in such taxable year on or before March 31, 1990, bears to the total number of days in such taxable year.

(f) STUDY OF DEPRECIATION TREATMENT OF CERTAIN VEHICLES.—

(1) IN GENERAL.—The Secretary of the Treasury or his delegate shall conduct a study on the proper class life for cars and light trucks.

(2) REPORT.—Not later than the day 1 year after the date of the enactment of this Act, the Secretary shall submit a report to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate on the report conducted under paragraph (1), together with such recommendations as he may deem advisable.

PART III—ACCOUNTING PROVISIONS

SEC. 7621. REPEAL OF COMPLETED CONTRACT METHOD OF ACCOUNTING FOR LONG-TERM CONTRACTS.

(a) IN GENERAL.—Subsection (a) of section 460 (relating to special rules for long-term contracts) is amended to read as follows:

"(a) REQUIREMENT THAT PERCENTAGE OF COMPLETION METHOD BE USED.—In the case of any long-term contract, the taxable income from such contract shall be determined under the percentage of completion method (as modified by subsection (b))."

(b) ELECTION TO USE MODIFIED PERCENTAGE OF COMPLETION METHOD.—Subsection (b) of section 460 (as amended by subsection (c)(1)) is amended by adding at the end thereof the following new paragraph:

"(5) ELECTION TO USE 10-PERCENT METHOD.—

"(A) GENERAL RULE.—In the case of any long-term contract with respect to which an election under this paragraph is in effect, the 10-percent method shall apply in determining the taxable income from such contract.

"(B) 10-PERCENT METHOD.—For purposes of this paragraph—

"(i) IN GENERAL.—The 10-percent method is the percentage of completion method, modified so that any item which would otherwise be taken into account in computing taxable income with respect to a contract for any taxable year before the 10-percent year is taken into account in the 10-percent year.

(ii) 10-PERCENT YEAR.—The term '10-percent year' means the 1st taxable year as of the close of which at least 10 percent of the estimated total contract costs have been incurred.

"(C) ELECTION.—An election under this paragraph shall apply to all long-term contracts of the taxpayer which are entered into during the taxable year in which the election is made or any subsequent taxable year.

"(D) COORDINATION WITH OTHER PROVISIONS.—

"(i) SIMPLIFIED METHOD OF COST ALLOCATION.—This paragraph shall not apply to any taxpayer which uses a simplified procedure for allocation of costs under paragraph (3)(A).

"(ii) LOOK-BACK METHOD.—The 10-percent method shall be taken into account for purposes of applying the look-back method of paragraph (2) to any taxpayer making an election under this paragraph."

(c) CONFORMING AMENDMENTS.—

(1) Subsection (b) of section 460 is amended by striking paragraph (1) and by redesignating paragraphs (2) through (5) as paragraphs (1) through (4), respectively.

(2) Paragraph (1) of section 460(b), as redesignated by paragraph (1), is amended—

(A) by striking "paragraph (4)" and inserting "paragraph (3)", and

(B) by striking "paragraph (3)" and inserting "paragraph (2)".

(3) Paragraph (3) of section 460(b), as redesignated by paragraph (1), is amended by striking "Paragraph (2)(B) and subsection (a)(2)" and inserting "Paragraph (1)(B)".

(4) Subparagraph (A) of section 460(b)(4), as redesignated by paragraph (1), is amended—

(A) by striking "paragraph (3)" each place it appears and inserting "paragraph (2)",

(B) by striking "paragraph (3)(B)" and inserting "paragraph (2)(B)", and

(C) by striking "paragraph (3)(A)" and inserting "paragraph (2)(A)".

(5) Paragraph (5) of section 460(e) is amended by striking so much of such paragraph as precedes subparagraph (A) and inserting the following:

"(5) SPECIAL RULE FOR RESIDENTIAL CONSTRUCTION CONTRACTS WHICH ARE NOT HOME CONSTRUCTION CONTRACTS.—In the case of any residential construction contract which is not a home construction contract, subsection (a) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1989) shall apply except that such subsection shall be applied—".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to contracts entered into on or after July 11, 1989.

(2) BINDING BIDS.—The amendments made by this section shall not apply to any contract resulting from the acceptance of a bid made before July 11, 1989. The preceding sentence shall apply only if the bid could not have been revoked or altered at any time on or after July 11, 1989.

(3) SPECIAL RULE FOR CERTAIN SHIP CONTRACTS.—The amendments made by this section shall not apply in the case of a qualified ship contract (as defined in section 10203(b)(2)(B) of the Revenue Act of 1987).

SEC. 7622. CHANGES IN TREATMENT OF TRANSFERS OF FRANCHISES, TRADEMARKS, AND TRADE NAMES.

(a) CONTINGENT PAYMENTS.—Paragraph (1) of section 1253(d) (relating to treatment of payments by transferee) is amended to read as follows:

"(1) CONTINGENT SERIAL PAYMENTS.—

"(A) IN GENERAL.—Any amount described in subparagraph (B) which is paid or incurred during the taxable year on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name shall be allowed as a deduction under

section 162(a) (relating to trade or business expenses).

"(B) AMOUNTS TO WHICH PARAGRAPH APPLIES.—An amount is described in this subparagraph if it—

"(i) is contingent on the productivity, use, or disposition of the franchise, trademark, or trade name, and

"(ii) is paid as part of a series of payments—

"(I) which are payable not less frequently than annually throughout the entire term of the transfer agreement, and

"(II) which are substantially equal in amount (or payable under a fixed formula)."

(b) $100,000 LIMITATION ON CERTAIN PAYMENTS.—

(1) IN GENERAL.—Paragraph (2) of section 1253(d) is amended by adding at the end thereof the following new subparagraph:

"(B) $100,000 LIMITATION ON DEDUCTIBILITY OF PRINCIPAL SUM.—Subparagraph (A) shall not apply if the principal sum referred to in such subparagraph exceeds $100,000. For purposes of the preceding sentence, all payments which are part of the same transaction (or a series of related transactions) shall be taken into account as payments with respect to each such transaction."

(2) CONFORMING AMENDMENTS.—Paragraph (2) of section 1253(d) is amended—

(A) by striking all that precedes "If" and inserting:

"(2) CERTAIN PAYMENTS IN DISCHARGE OF PRINCIPAL SUMS.—

"(A) IN GENERAL.—", and

(B) by redesignating subparagraphs (A), (B), and (C) as clauses (i), (ii), and (iii), respectively, and by redesignating clauses (i) and (ii) of subparagraph (B) as subclauses (I) and (II), respectively.

(c) OTHER PAYMENTS, ETC.—Section 1253(d) is amended by adding at the end thereof the following new paragraphs:

"(3) OTHER PAYMENTS—

"(A) IN GENERAL.—Any amount paid or incurred on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name to which paragraph (1) or (2) does not apply shall be treated as an amount chargeable to capital account.

"(B) ELECTION TO RECOVER AMOUNTS OVER 25 YEARS.—

"(i) IN GENERAL.—If the taxpayer elects the application of this subparagraph, an amount chargeable to capital account—

"(I) to which paragraph (1) would apply but for subparagraph (B)(ii) thereof, or

"(II) to which paragraph (2) would apply but for subparagraph (B) thereof,

shall be allowed as a deduction ratably over the 25-year period beginning with the taxable year in which the transfer occurs.

"(ii) CONSISTENT TREATMENT.—An election under clause (i) shall apply to all amounts which are part of the same transaction (or a series of related transactions).

"(4) RENEWALS, ETC.—For purposes of determining the term of a transfer agreement or any period of amortization under this subsection, there shall be taken into account all renewal options (and any other period for which the parties reasonably expect the agreement to be renewed).

"(5) CERTAIN RULES MADE APPLICABLE.—Rule similar to the rules of section 168(i)(7) shall apply for purposes of this subsection."

(b) TECHNICAL AMENDMENTS.—

(1) DEPRECIATION ALLOWABLE.—Subsection (r) of section 167 is hereby repealed.

(2) DEDUCTION SUBJECT TO RECAPTURE.—

(A) Subparagraph (C) of section 1245(a)(2) is amended by striking "or 193" and inserting "193, or 1253(d)(2) or (3)".

(B) The material preceding subparagraph (A) of section 1245(a)(3) is amended by striking "section 185: and inserting "section 185 or 1253(d)(2) or (3)".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to transfers after October 2, 1989.

(2) BINDING CONTRACT.—The amendments made by this section shall not apply to any transfer pursuant to a written binding contract in effect on October 2, 1989, and at all times thereafter before the transfer.

PART IV—EMPLOYMENT TAX PROVISIONS

SEC. 7631. TREATMENT OF AGRICULTURAL WORKERS UNDER WAGE WITHHOLDING.

(a) IN GENERAL.—Paragraph (2) of section 3401(a) (defining wages) is amended to read as follows:

"(2) for agricultural labor (as defined in section 3121(g)) unless the remuneration paid for such labor is wages (as defined in section 3121(a)); or".

(b) CREW LEADER RULES TO APPLY.—Section 3401 is amended by adding at the end thereof the following new subsection:

"(h) CREW LEADER RULES TO APPLY.—Rules similar to the rules of section 3121(o) shall apply for purposes of this chapter."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to a remuneration paid after December 31, 1989.

SEC. 7632. ACCELERATION OF DEPOSIT REQUIREMENTS.

(a)IN GENERAL.—Section 6302 (relating to mode or time for collection), as amended by this title, is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) DEPOSITS OF SOCIAL SECURITY TAXES AND WITHHELD INCOME TAXES.—

"(1) IN GENERAL.—If, under regulations prescribed by the Secretary, a person is required to make deposits of taxes imposed by chapters 21 and 24 on the basis of eighth-month periods, such person shall, for the years specified in paragraph (2), make deposits of such taxes on the applicable banking day after any day on which such person has $100,000 or more of such taxes for deposit.

"(2) SPECIFIED YEARS.—For purposes of paragraph (1)—

"In the case of:	The applicable banking day is:
1990	1st
1991	2d
1992	3rd
1993	1st
1994	1st."

(b) EFFECTIVE DATE.—

(1) GENERAL RULE.—Except as provided in paragraph (2), the amendment made by subsection (a) shall apply to amounts required to be deposited after July 31, 1990.

(2) RULE FOR 1995 AND THEREAFTER.—For calendar year 1995 and thereafter, the Secretary of the Treasury shall prescribe regulations with respect to the date on which deposits of such taxes shall be made in order to minimize the unevenness in the revenue effects of the amendment made by subsection (a).

PART V—OTHER PROVISIONS

SEC. 7641. LIMITATION ON SECTION 104 EXCLUSION.

(a) GENERAL RULE.—Section 104(a) (relating to compensation for injuries or sickness) is amended by adding at the end thereof the following new sentence: "Paragraph (2) shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by subsection (a) shall apply to amounts received after July 10, 1989, in taxable years ending after such date.

(2) EXCEPTION.—The amendment made by subsection (a) shall not apply to any amount received—

(A) under any written binding agreement, court decree, or mediation award in effect on (or issued on or before) July 10, 1989, or

(B) pursuant to any suit filed on or before July 10, 1989.

SEC. 7642.—TREATMENT OF DISTRIBUTIONS BY PARTNERSHIPS OF CONTRIBUTED PROPERTY.

(a) GENERAL RULE.—Subsection (c) of section 704 (relating to contributed property) is amended to read as follows:

"(c) CONTRIBUTED PROPERTY.—

"(1) IN GENERAL.—Under regulations prescribed by the Secretary—

"(A) income, gain, loss, and deduction with respect to property contributed to the partnership by a partner shall be shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution, and

"(B) if any property so contributed is distributed by the partnership (other than to the contributing partner) within 5 years of being contributed—

"(i) the contributing partner shall be treated as recognizing gain or loss (as the case may be) from the sale of such property in an amount equal to the gain or loss which would have been allocated to such partner under subparagraph (A) by reason of the variation described in subparagraph (A) if the property had been sold at its fair market value at the time of the distribution,

"(ii) the character of such gain or loss shall be determined by reference to the character of the gain or loss which would have resulted if such property had been sold by the partnership to the distributee, and

"(iii) appropriate adjustments shall be made to the adjusted basis of the contributing partner's interest in the partnership and to the adjusted basis of the property distributed to reflect any gain or loss recognized under this subparagraph.

"(2) SPECIAL RULE FOR DISTRIBUTION WHERE GAIN OR LOSS WOULD NOT BE RECOGNIZED OUTSIDE PARTNERSHIPS.—Under regulations prescribed by the Secretary, if—

"(A) property contributed by a partner (hereinafter referred to as the 'contributing partner') is distributed by the partnership to another partner, and

"(B) other property of a like kind (within the meaning of section 1031) is distributed by the partnership to the contributing partner not later than the earlier of—

"(i) the 180th day after the date of the distribution described in subparagraph (A), or

"(ii) the due date (determined with regard to extensions) for the contributing partner's return of the tax imposed by this chapter for the taxable year in which the distribution described in subparagraph (A) occurs,

then to the extent of the value of the property described in subparagraph (B), paragraph (1)(B) shall be applied as if the contributing partner had contributed to the partnership the property described in subparagraph (B).

"(3) OTHER RULES.—Under regulations prescribed by the Secretary, rules similar to the rules of paragraph (1) shall apply to contributions by a partner (using the cash receipts and disbursements method of accounting) of accounts payable and other accrued but unpaid items. Any reference in paragraph (1) or (2) to the contributing partner shall be treated as including a reference to any successor of such partner."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply in the case of property contributed to the partnership after October 3, 1989, in taxable years ending after such date.

SEC. 7643. DEPRECIATION TREATMENT OF CELLULAR TELEPHONES.

(a) GENERAL RULE.—Subparagraph (A) of section 280F(d)(4) (defining listed property) is amended by striking "and" at the end of clause (iv), by redesignating clause (v) as clause (vi), and by inserting after clause (iv) the following new clause:

"(v) any cellular telephone (or other similar telecommunications equipment), and".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to property placed in service or leased in taxable years beginning after December 31, 1989.

SEC. 7644. ELIMINATION OF RETROACTIVE CERTIFICATION OF EMPLOYEES FOR WORK INCENTIVE JOBS CREDIT.

(a) IN GENERAL.—So much of subparagraph (A) of section 50B(h)(1) of the Internal Revenue Code of 1954 (as in effect for taxable years beginning before January 1, 1982) as precedes clause (i) thereof is amended to read as follows:

"(A) who has been certified (or for whom a written request for certification has been made) on or before the day the individual began work for the taxpayer by the Secretary of Labor or by the appropriate agency of State or local government as—".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply for purposes of credits first claimed after March 11, 1987.

SEC. 7645. DISALLOWANCE OF DEPRECIATION FOR CERTAIN TERM INTERESTS.

(a) GENERAL RULE.—Section 167 (as amended by section 7622) is amended by inserting after subsection (q) the following new subsection:

"(r) CERTAIN TERM INTERESTS NOT DEPRECIABLE.—

"(1) IN GENERAL.—No depreciation deduction shall be allowed under this section (and no depreciation or amortization deduction shall be allowed under any other provision of this subtitle) to the taxpayer for any term interest in property for any period during which the remainder interest in such property is held (directly or indirectly) by a related person.

"(2) COORDINATION WITH SECTION 273.—This subsection shall not apply to any term interest to which section 273 applies.

"(3) BASIS ADJUSTMENTS.—If, but for this subsection, a depreciation or amortization deduction would be allowable to the taxpayer with respect to any term interest in property—

"(A) the taxpayer's basis in such property shall be reduced by any depreciation or amortization deductions disallowed under this subsection, and

"(B) the basis of the remainder interest in such property shall be increased by the amount of such disallowed deductions (properly adjusted for any depreciation deductions allowable under subsection (h) to the taxpayer).

"(4) SPECIAL RULES.—

"(A) DENIAL OF INCREASE IN BASIS OF REMAINDERMAN.—No increase in the basis of the remainder interest shall be made under paragraph (3)(B) for any disallowed deductions attributable to periods during which the term interest was held—

"(i) by an organization exempt from tax under this subtitle, or

"(ii) by a nonresident alien individual or foreign corporation but only if income from the term interest is not effectively connected with the conduct of a trade or business in the United States.

"(B) COORDINATION WITH SUBSECTION (h).—If, but for this subsection, a depreciation or amortization deduction would be allowable to any person with respect to any term interest in property, the principles of subsection (h) shall apply to such person with respect to such term interest.

"(5) DEFINITIONS.—For purposes of this subsection—

"(A) TERM INTEREST IN PROPERTY.—The term 'term interest in property' has the meaning given such term by section 1001(e)(2).

"(B) RELATED PERSON.—The term 'related person' means any person bearing a relationship to the taxpayer described in subsection (b) or (e) of section 267.

"(6) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations preventing avoidance of this subsection through cross-ownership arrangements or otherwise."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to interests created or acquired after July 27, 1989, in taxable years ending after such date.

SEC. 7646. REPORTING OF POINTS ON MORTGAGE LOANS.

(a) GENERAL RULE.—Paragraph (2) of section 6050H(b) (relating to form and manner of returns) is amended by striking "and" at the end of subpararaph (B), by redesignating subparagraph (C) as subparagraph (D) and by inserting after subparagraph (B) the following new subparagraph:

"(C) the amount of points on the mortgage received during the calendar year and whether such points were paid directly by the borrower, and".

(b) TECHNICAL AMENDMENTS.—

(1) Subparagraph (B) of section 6050H(b)(1) is amended by inserting "(other than points)" after "such interest".

(2) Paragraph (2) of section 6050H(d) is amended—

(A) by inserting "(other than points)" after "subsection (a)(2)", and

(B) by inserting before the period at the end thereof the following: "(and the information required under subsection (b)(2)(C))".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to returns and statements the due date for which (determined without regard to extensions) is after December 31, 1991.

SEC. 7647. TREATMENT OF CERTAIN INVESTMENT-ORIENTED LIFE INSURANCE CONTRACTS.

(a) GENERAL RULE.—Subsection (c) of section 7702A (relating to computational rules) is amended by adding at the end thereof the following new paragraph:

"(6) TREATMENT OF CERTAIN CONTRACTS WITH MORE THAN ONE INSURED.—If—

"(A) a contract provides a death benefit which is payable only upon the death of 1 insured following (or occurring simultaneously with) the death of another insured, and

"(B) there is a reduction in such death benefit below the lowest level of such death benefit provided under the contract during the 1st 7 contract years,

this section shall be applied as if the contract had originally been issued at the reduced benefit level."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall

apply to contracts entered into on or after September 14, 1989.

PART VI—TAX-EXEMPT BOND PROVISIONS

SEC. 7651. TREATMENT OF HEDGE BONDS.

(a) IN GENERAL.—Section 149 (relating to bonds must be registered to be tax-exempt; other requirements) is amended by adding at the end thereof the following new subsection:

"(g) TREATMENT OF HEDGE BONDS.—

"(1) IN GENERAL.—Section 103(a) shall not apply to any hedge bond unless, with respect to the issue of which such bond is a part—

"(A) the requirement of paragraph (2) is met, and

"(B) the requirement of subsection (f)(3) is met.

"(2) REASONABLE EXPECTATIONS AS TO WHEN PROCEEDS WILL BE SPENT.—An issue meets the requirement of this paragraph if the issuer reasonably expects that—

"(A) 10 percent of the spendable proceeds of the issue will be spent for the governmental purposes of the issue within the 1-year period beginning on the date the bonds are issued,

"(B) 30 percent of the spendable proceeds of the issue will be spent for such purposes within the 2-year period beginning on such date,

"(C) 60 percent of the spendable proceeds of the issue will be spent for such purposes within the 3-year period beginning on such date, and

"(D) 85 percent of the spendable proceeds of the issue will be spent for such purposes within the 5-year period beginning on such date.

"(3) HEDGE BOND.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'hedge bond' means any bond issued as part of an issue unless—

"(i) the issuer reasonably expects that 85 percent of the spendable proceeds of the issue will be used to carry out the governmental purposes of the issue within the 3-year period beginning on the date the bonds are issued, and

"(ii) not more than 50 percent of the proceeds of the issue are invested in nonpurpose investments (as defined in section 148(f)(6)(A)) having a substantially guaranteed yield for 4 years or more.

"(B) EXCEPTION FOR INVESTMENT IN TAX-EXEMPT BONDS NOT SUBJECT TO MINIMUM TAX.—

"(i) IN GENERAL.—Such term shall not include any bond issued as part of an issue 95 percent of the net proceeds of which are invested in bonds—

"(I) the interest on which is not includible in gross income under section 103, and

"(II) which are not specified private activity bonds (as defined in section 57(a)(5)(C)).

"(ii) AMOUNTS IN BONA FIDE DEBT SERVICE FUND.—Amounts in a bona fide debt service fund shall be treated as invested in bonds described in clause (i).

"(iii) INVESTMENT EARNINGS HELD PENDING REINVESTMENT.—Investment earnings held for not more than 30 days pending reinvestment shall be treated as invested in bonds described in clause (i).

"(C) EXCEPTION FOR REFUNDING BONDS.—

"(i) IN GENERAL.—A refunding bond shall be treated as meeting the requirements of this subsection only if the original bond met such requirements.

"(ii) GENERAL RULE FOR REFUNDING OF PRE-EFFECTIVE DATE BONDS.—A refunding bond shall be treated as meeting the requirements of this subsection if—

"(I) this subsection does not apply to the original bond,

"(II) the average maturity date of the issue of which the refunding bond is a part is not later than the average maturity date of the bonds to be refunded by such issue, and

"(III) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond.

"(iii) REFUNDING OF PRE-EFFECTIVE DATE BONDS ENTITLED TO 5-YEAR TEMPORARY PERIOD.—A refunding bond shall be treated as meeting the requirements of this subsection if—

"(I) this subsection does not apply to the original bond,

"(II) the issuer reasonably expected that 85 percent of the spendable proceeds of the issue of which the original bond is a part would be used to carry out the governmental purposes of the issue within the 5-year period beginning on the date the original bonds were issued but did not reasonably expect that 85 percent of such proceeds would be so spent within the 3-year period beginning on such date, and

"(III) at least 85 percent of the spendable proceeds of the original issue (and all other prior original issues issued to finance the governmental purposes of such issue) were spent before the date the refunding bonds are issued.

"(4) SPECIAL RULES.—For purposes of this subsection—

"(A) CONSTRUCTION PERIOD IN EXCESS OF 5 YEARS.—The Secretary may, at the request of any issuer, provide that the requirement of paragraph (2) shall be treated as met with respect to the portion of the spendable proceeds of an issue which is to be used for any construction project having a construction period in excess of 5 years if it is reasonably expected that such proceeds will be spent over a reasonable construction schedule specified in such request.

"(B) RULES FOR DETERMINING EXPECTATIONS.—The rules of subsection (f)(2)(B) shall apply.

"(5) REGULATIONS.—The Secretary may prescribe regulations to prevent the avoidance of the rules of this subsection, including through the aggregation of projects within a single issue."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection,

the amendment made by subsection (a) shall apply to bonds issued after September 14, 1989.

(2) BONDS SOLD BEFORE SEPTEMBER 15, 1989.—The amendment made by subsection (a) shall not apply to any bond sold before September 15, 1989, and issued before October 15, 1989.

(3) BONDS WITH RESPECT TO WHICH PRELIMINARY OFFERING MATERIALS MAILED.—The amendment made by subsection (a) shall not apply to any issue issued after the date of the enactment of this Act if the preliminary offering materials with respect to such issue were mailed (or otherwise delivered) to members of the underwriting syndicate before September 15, 1989.

(4) CERTAIN OTHER BONDS.—In the case of a bond issued before January 1, 1991, with respect to which official action was taken (or a series of official actions were taken), or other comparable preliminary approval was given, before November 18, 1989, demonstrating an intent to issue such bonds in a maximum specified amount for such issue or within a maximum specified amount of net proceeds of such issue, the issuer may elect to apply section 149(g)(2) of the Internal Revenue Code of 1986 (as added by this section) by substituting "15 percent" for "10 percent" in subparagraph (A) and "50 percent" for "60 percent" in subparagraph (C).

(5) BONDS ISSUED TO FINANCE SELF-INSURANCE FUNDS.—The amendment made by subsection (a) shall not apply to any bonds issued before July 1, 1990, to finance a self-insurance fund if official action was taken (or a series of official actions were taken), or other comparable preliminary approval was given, before September 15, 1989, demonstrating an intent to issue such bonds in a maximum specified amount for such issue or with a maximum specified amount of net proceeds of such issue.

SEC. 7652. EXCEPTIONS FROM ARBITRAGE REBATE REQUIREMENT.

(a) IN GENERAL.--Clause (i) of section 148(f)(4)(B) (relating to temporary investments) is amended to read as follows:

"(i) IN GENERAL.—An issue shall, for purposes of this subsection, be treated as meeting the requirements of paragraph (2) if—

"(I) the gross proceeds of such issue are expended for the governmental purposes for which the issue was issued no later than the day which is 6 months after the date of issuance of the issue, and

"(II) the requirements of paragraph (2) are met after such 6 months with respect to earnings on amounts in any reasonably required reserve or replacement fund.

Gross proceeds which are held in a bona fide debt service fund or a reasonably required reserve or replacement fund shall not be considered gross proceeds for purposes of this subparagraph only."

(b) CONSTRUCTION BONDS.—Subparagraph (B) of section 148(f)(4) (relating to temporary investments) is amended by adding at the end thereof the following new clause:

"(iv) 2-YEAR PERIOD FOR CERTAIN CONSTRUCTION BONDS.—

"(I) IN GENERAL.—In the case of an issue described in subclause (IV), clause (i) shall be applied by substituting '2 years' for '6 months' each place it appears.

"(II) PROCEEDS MUST BE SPENT WITHIN CERTAIN PERIODS.—Subclause (I) shall not apply to any issue if less than 10 percent of the net proceeds of the issue are spent for the governmental purposes of the issue within the 6-month period beginning on the date the bonds are issued, less than 45 percent of such proceeds are spent for such purposes within the 1-year period beginning on such date, less than 75 percent of such proceeds are spent for such purposes within the 18-month period beginning on such date, or less than 100 percent of such proceeds are spent for such purposes within the 2-year period beginning on such date. For purposes of the preceding sentence, the term 'net proceeds' includes investment proceeds earned before the close of the period involved on the investment of the sale proceeds of the issue.

"(III) EXCEPTION FOR REASONABLE RETAINAGE.—For purposes of subclause (II), 100 percent of the net proceeds of an issue shall be treated as spent for the governmental purposes of the issue within the 2-year period beginning on the date the bonds are issued if such requirement is met within the 3-year period beginning on such date and such requirement would have been met within such 2-year period but for a reasonable retainage (not exceeding 5 percent of the net proceeds of the issue).

"(IV) ISSUES TO WHICH SUBCLAUSE (I) APPLIES.—An issue is described in this subclause if at least 75 percent of the net proceeds of the issue are to be used for construction expenditures with respect to property which is owned by a governmental unit or a 501(c)(3) organization. For purposes of the preceding sentence, the term 'construction' includes reconstruction and rehabilitation, and section 142(b)(1) shall apply. An issue is not described in this subclause if any bond which is part of such issue is a bond other than a qualified 501(c)(3) bond, a bond which is not a private activity bond, or a private activity bond to finance property to be owned by a governmental unit or a 501(c)(3) organization.

"(V) ELECTION TO PAY PENALTY IN LIEU OF REBATE.—In the case of an issue described in subclause (IV) which fails to meet the requirements of subclause (II), if the issuer elected the application of this subclause, the requirements of paragraph (2) shall be treated as

met if the issuer pays the penalty under paragraph (7) or pays a penalty with respect to the close of each 6 month period after the date the bonds are issued equal to 1 1/2 percent of the amount of the net proceeds of the issue which, as of the close of such period, are not spent as required by subclause (II). The penalty under this subclause shall cease to apply only after the bonds (including any refunding bonds with respect thereto) are no longer outstanding.

"(VI) ELECTION TO REBATE ON EARNINGS ON RESERVE.—If the issuer so elects, the term 'net proceeds' for purposes of subclause (II) shall not include earnings on any reasonably required reserve or replacement fund and the requirements of paragraph (2) shall apply to such earnings.

"(VII) POOLED FINANCING BONDS.—At the election of the issuer of an issue the proceeds of which are to be used to make or finance loans (other than nonpurpose investments) to 2 or more persons, the periods described in clause (i) and this clause shall begin on the date the loan is made in the case of loans made within the 1-year period after the date the bonds were issued. In the case of loans made after such 1-year period, the periods described in clause (i) and this clause shall begin at the close of such 1-year period.

"(VIII) PORTIONS OF ISSUE MAY BE TREATED SEPARATELY.—If only a portion of an issue is to be used for construction expenditures referred to in subclause (IV), such portion and the other portion of such issue may, at the election of the issuer, be treated as separate issues for purposes of this clause and clause (i).

"(IX) ELECTIONS.—Any election under this clause shall be made on or before the date the bonds are issued; and, once made, shall be irrevocable."

(c) POOLED FINANCING BONDS.—Subparagraph (A) of section 148(c)(2) is amended by redesignating subparagraph (D) as subparagraph (E) and by inserting after subparagraph (C) the following new subparagraph:

"(D) BONDS USED TO PROVIDE CONSTRUCTION FINANCING.—In the case of an issue described in subparagraph (A) any portion of which is used to make or finance loans for construction expenditures (within the meaning of subsection (f)(4)(B)(iv)(IV))—

"(i) rules similar to the rules of subsection (f)(4)(B)(iv)(VIII) shall apply, and

"(ii) subparagraph (A) shall be applied with respect to such portion by substituting '2 years' for '6 months'."

(d) CONFORMING AMENDMENT.—Subclause (I) of section 148(f)(4)(B)(ii) is amended by inserting "each place it appears" after " '6 months' ".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to bonds issued after the date of the enactment of this Act.

Subtitle G—Revision of Civil Penalties

SEC. 7701. SHORT TITLE.

This subtitle may be cited as the "Improved Penalty Administration and Compliance Tax Act".

PART I—DOCUMENT AND INFORMATION RETURN PENALTIES

SEC. 7711. UNIFORM PENALTIES FOR FAILURES TO COMPLY WITH CERTAIN INFORMATION REPORTING REQUIREMENTS.

(a) GENERAL RULE.—Part II of subchapter B of chapter 68 (relating to failure to file certain information returns or statements) is amended to read as follows:

"PART II—FAILURE TO COMPLY WITH CERTAIN INFORMATION REPORTING REQUIREMENTS

"Sec. 6721. Failure to file correct information returns.

"Sec. 6722. Failure to furnish correct payee statements.

"Sec. 6723. Failure to comply with other information reporting requirements.

"Sec. 6724. Waiver; definitions and special rules.

"SEC. 6721. FAILURE TO FILE CORRECT INFORMATION RETURNS.

"(a) IMPOSITION OF PENALTY.—

"(1) IN GENERAL.—In the case of a failure described in paragraph (2) by any person with respect to an information return, such person shall pay a penalty of $50 for each return with respect to which such a failure occurs, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $250,000.

"(2) FAILURES SUBJECT TO PENALTY.—For purposes of paragraph (1), the failures described in this paragraph are—

"(A) any failure to file an information return with the Secretary on or before the required filing date, and

"(B) any failure to include all of the information required to be shown on the return or the inclusion of incorrect information.

"(b) REDUCTION WHERE CORRECTION IN SPECIFIED PERIOD.—

"(1) CORRECTION WITHIN 30 DAYS.—If any failure described in subsection (a)(2) is corrected on or before the day 30 days after the required filing date—

"(A) the penalty imposed by subsection (a) shall be $15 in lieu of $50, and

"(B) the total amount imposed on the person for all such failures during any calendar year which are so corrected shall not exceed $75,000.

"(2) FAILURES CORRECTED ON OR BEFORE AUGUST 1.—If any failure described in subsection (a)(2) is corrected after the 30th day referred to in paragraph (1) but on or before August 1 of the calendar year in which the required filing date occurs—

"(A) the penalty imposed by subsection (a) shall be $30 in lieu of $50, and

"(B) the total amount imposed on the person for all such failures during the calendar year which are so corrected shall not exceed $150,000.

"(c) EXCEPTION FOR DE MINIMIS FAILURES TO INCLUDE ALL REQUIRED INFORMATION.—

"(1) IN GENERAL.—If—

"(A) an information return is filed with the Secretary,

"(B) there is a failure described in subsection (a)(2)(B) (determined after the application of section 6724(a)) with respect to such return, and

"(C) such failure is corrected on or before August 1 of the calendar year in which the required filing date occurs,

for purposes of this section, such return shall be treated as having been filed with all of the correct required information.

"(2) LIMITATION.—The number of information returns to which paragraph (1) applies for any calendar year shall not exceed the greater of—

"(A) 10, or

"(B) one-half of 1 percent of the total number of information returns required to be filed by the person during the calendar year.

"(d) LOWER LIMITATIONS FOR PERSONS WITH GROSS RECEIPTS OF NOT MORE THAN $5,000,000.—

"(1) IN GENERAL.—If any person meets the gross receipts test of paragraph (2) with respect to any calendar year, with respect to failures during such taxable year—

"(A) subsection (a)(1) shall be applied by substituting '$100,000' for '$250,000',

"(B) subsection (b)(1)(B) shall be applied by substituting '$25,000' for '$75,000', and

"(C) subsection (b)(2)(B) shall be applied by substituting '$50,000' for '$150,000'.

"(2) GROSS RECEIPTS TEST.—

"(A) IN GENERAL.—A person meets the gross receipts test of this paragraph for any calendar year if the average annual gross receipts of such person for the most recent 3 taxable years ending before such calendar year do not exceed $5,000,000.

"(B) CERTAIN RULES MADE APPLICABLE.—For purposes of subparagraph (A), the rules of paragraphs (2) and (3) of section 448(c) shall apply.

"(e) PENALTY IN CASE OF INTENTIONAL DISREGARD.—If 1 or more failure. described in subsection (a)(2) are due to intentional disregard of the filing requirement (or the correct information reporting requirement), then, with respect to each such failure—

"(1) subsections (b), (c), and (d) shall not apply,

"(2) the penalty imposed under subsection (a) shall be $100, or, if greater—

"(A) in the case of a return other than a return required under section 6045(a), 6041A(b), 6050H, 6050J, 6050K, or 6050L, 10 percent of the aggregate amount of the items required to be reported correctly, or

"(B) in the case of a return required to be filed by section 6045(a), 6050K, or 6050L, 5 percent of the aggregate amount of the items required to be reported correctly, and

"(3) in the case of any penalty determined under paragraph (2)—

"(A) the $250,000 limitation under subsection (a) shall not apply, and

"(B) such penalty shall not be taken into account in applying such limitation (or any similar limitation under subsection (b)) to penalties not determined under paragraph (2).

"SEC. 6722. FAILURE TO FURNISH CORRECT PAYEE STATEMENTS.

"(a) GENERAL RULE.—In the case of each failure described in subsection (b) by any person with respect to a payee statement, such person shall pay a penalty of $50 for each statement with respect to which such a failure occurs, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $100,000.

"(b) FAILURES SUBJECT TO PENALTY.—For purposes of subsection (a), the failures described in this subsection are—

"(1) any failure to furnish a payee statement on or before the date prescribed therefor to the person to whom such statement is required to be furnished, and

"(2) any failure to include all of the information required to be shown on a payee statement or the inclusion of incorrect information.

"(c) PENALTY IN CASE OF INTENTIONAL DISREGARD.—If 1 or more failures to which subsection (a) applies are due to intentional disregard of the requirement to furnish a payee statement (or the correct information reporting requirement), then, with respect to each failure—

"(1) the penalty imposed under subsection (a) shall be $100, or, if greater—

"(A) in the case of a payee statement other than a statement required under section 6045(b), 6041A(e) (in respect of a return required under section 6041A(b)), 6050H(d), 6050J(e), 6050K(b), or 6050L(c), 10 percent of the aggregate amount of the items required to be reported correctly, or

"(B) in the case of a payee statement required under section 6045(b), 6050K(b), or 6050L(c), 5 percent of the aggregate amount of the items required to be reported correctly, and

"(2) in the case of any penalty determined under paragraph (1)—

"(A) the $100,000 limitation under subsection (a) shall not apply, and

"(B) such penalty shall not be taken into account in applying such limitation to penalties not determined under paragraph (1).

"SEC. 6723. FAILURE TO COMPLY WITH OTHER INFORMATION REPORTING REQUIREMENTS.

"In the case of a failure by any person to comply with a specified information reporting requirement on or before the time prescribed therefor, such person shall pay a penalty of $50 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $100,000.

'SEC. 6724. WAIVER; DEFINITIONS AND SPECIAL RULES.

"(a) REASONABLE CAUSE WAIVER.—No penalty shall be imposed under this part with respect to any failure if it is shown that such failure is due to reasonable cause and not to willful neglect.

"(b) PAYMENT OF PENALTY.—Any penalty imposed by this part shall be paid on notice and demand by the

Secretary and in the same manner as tax.

"(c) SPECIAL RULE FOR FAILURE TO MEET MAGNETIC MEDIA REQUIREMENTS.—No penalty shall be imposed under section 6721 solely by reason of any failure to comply with the requirements of the regulations prescribed under section 6011(e)(2), except to the extent that such a failure occurs with respect to more than 250 information returns.

"(d) DEFINITIONS.—For purposes of this part—

"(1) INFORMATION RETURN.—The term 'information return' means—

"(A) any statement of the amount of payments to another person required by—

"(i) section 6041(a) or (b) (relating to certain information at source),

"(ii) section 6042(a)(1) (relating to payments of dividends),

"(iii) section 6044(a)(1) (relating to payments of patronage dividends),

"(iv) section 6049(a) (relating to payments of interest),

"(v) section 6050A(a) (relating to reporting requirements of certain fishing boat operators),

"(vi) section 6050N(a) (relating to payments of royalties), or

"(vii) section 6051(d) (relating to information returns with respect to income tax withheld), and

"(B) any return required by—

"(i) section 6041A(a) or (b) (relating to returns of direct sellers),

"(ii) section 6045(a) or (d) (relating to returns of brokers).

"(iii) section 6050H(a) (relating to mortgage interest received in trade or business from individuals),

"(iv) section 6050I(a) (relating to cash received in trade or business),

"(v) section 6050J(a) (relating to foreclosures and abandonments of security),

"(vi) section 6050K(a) (relating to exchanges of certain partnership interests),

"(vii) section 6050L(a) (relating to returns relating to certain dispositions of donated property),

"(viii) section 6052(a) (relating to reporting payment of wages in the form of group-life insurance),

"(ix) section 6053(c)(1) (relating to reporting with respect to certain tips),

"(x) section 1060(b) (relating to reporting requirements of transferors and transferees in certain asset acquisitions), or

"(xi) subparagraph (A) or (C) of subsection (c)(4), or subsection (e), of section 4093 (relating to information reporting with respect to tax on diesel and aviation fuels).

Such term also includes any form, statement, or schedule required to be filed with the Secretary with respect to any amount from which tax was required to be deducted and withheld under chapter 3 (or from which tax would be required to be so deducted and withheld but for an exemption under this title or any treaty obligation of the United States).

"(2) PAYEE STATEMENT.—The term 'payee statement' means any statement required to be furnished under—

"(A) section 6031(b) or (c), 6034A, or 6037(b) (relating to statements furnished by certain pass-thru entities),

"(B) section 6039(a) (relating to information required in connection with certain options),

"(C) section 6041(d) (relating to information at source),

"(D) section 6041A(e) (relating to returns regarding payments of remuneration for services and direct sales),

"(E) section 6042(c) (relating to returns regarding payments of dividends and corporate earnings and profits),

"(F) section 6044(e) (relating to returns regarding payments of patronage dividends),

"(G) section 6045(b) or (d) (relating to returns of brokers),

"(H) section 6049(c) (relating to returns regarding payments of interest),

"(I) section 6050A(b) (relating to reporting requirements of certain fishing boat operators),

"(J) section 6050H(d) (relating to returns relating to mortgage interest received in trade or business from individuals),

"(K) section 6050I(e) (relating to returns relating to cash received in trade or business),

"(L) section 6050J(e) (relating to returns relating to foreclosures and abandonments of security),

"(M) section 6050K(b) (relating to returns relating to exchanges of certain partnership interests),

"(N) section 6050L(c) (relating to returns relating to certain dispositions of donated property),

"(O) section 6050N(b) (relating to returns regarding payments of royalties),

"(P) section 6051 (relating to receipts for employees),

"(Q) section 6052(b) (relating to returns regarding payment of wages in the form of group-term life insurance),

"(R) section 6053(b) or (c) (relating to reports of tips), or

"(S) section 4093(c)(4)(B) (relating to certain purchasers of diesel and aviation fuels).

Such term also includes any form, statement, or schedule required to be furnished to the recipient of any amount from which tax was required to be deducted and withheld under chapter 3 (or from which tax would be required to be so deducted and withheld but for an exemption under this title or any treaty obligation of the United States).

"(3) SPECIFIED INFORMATION REPORTING REQUIREMENT.—The term 'specified information reporting requirement' means—

"(A) the notice required by section 6050K(c)(1) (relating to requirement that transferor notify partnership of exchange),

"(B) any requirement contained in the regulations prescribed under section 6109 that a person—

"(i) include his TIN on any return, statement, or other document (other than an information return or payee statement),

"(i) furnish his TIN to another person, or

"(iii) include on any return, statement, or other document (other than an information return or payee statement) made with respect to another person the TIN of such person,

"(C) any requirement contained in the regulations prescribed under section 215 that a person—

"(i) furnish his TIN to another person, or

"(ii) include on his return the TIN of another person, and

"(D) the requirement of section 6109(e) that a person include the TIN of any dependent on his return.

"(4) REQUIRED FILING DATE.—The term 'required filing date' means the date prescribed for filing an information return with the Secretary (determined with regard to any extension of time for filing)."

(b) TECHNICAL AMENDMENTS.—

(1) Sections 6017A, 6676, and 6687 are hereby repealed.

(2) Subsection (b) of section 7205 is amended to read as follows:

"(b) BACKUP WITHHOLDING ON INTEREST AND DIVIDENDS.—If any individual willfully makes a false certification under paragraph (1) or (2)(C) of section 3406(d), then such individual shall, in addition to any other penalty provided by law, upon conviction thereof, be fined not more than $1,000, or imprisoned not more than 1 year, or both."

(3) The table of sections for subpart B of part II of subchapter A of chapter 61 is amended by striking the item relating to section 6017A.

(4) The table of sections for part I of subchapter B of chapter 68 is amended by striking the items relating to sections 6676 and 6687.

(5) The table of parts for subchapter B of chapter 68 is amended by striking the item relating to part II and inserting the following:

"Part II. Failure to comply with certain information reporting requirements."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to returns and statements the due date for which (determined without regard to extensions) is after December 31, 1989.

SEC. 7712. INFORMATION REQUIRED WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.

(a) CLARIFICATION OF REPORTING REQUIREMENTS UNDER SECTION 6038.—

(1) Subsection (a) of section 6038 (relating to information with respect to certain foreign corporations) is amended by adding at the end thereof the following new paragraph:

"(4) INFORMATION REQUIRED FROM CERTAIN SHAREHOLDERS IN CERTAIN CASES.—If any foreign corporation is treated as a controlled foreign corporation for any purpose under subpart F of part III of subchapter N of chapter 1, the Secretary may require any United States person treated as a United States shareholder of such corporation for any purpose under subpart F to furnish the information required under paragraph (1)."

(2) Paragraph (1) of section 6038(a) is amended by inserting before the period at the end of the second sentence the following: "or which the Secretary determines to be appropriate to carry out the provisions of this title."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to returns and statements the due date for which (determined without regard to extensions) is after December 31, 1989.

SEC. 7713. UNIFORM REQUIREMENTS FOR RETURNS ON MAGNETIC MEDIA.

(a) GENERAL RULE.—Subsection (e) of section 6011 (relating to regulations requiring returns on magnetic tape, etc.) is amended to read as follows:

"(e) REGULATIONS REQUIRING RETURNS ON MAGNETIC MEDIA, ETC.—

"(1) IN GENERAL.—The Secretary shall prescribe regulations providing standards for determining which returns must be filed on magnetic media or in other machine-readable form. The Secretary may not require returns of any tax imposed by subtitle A on individuals, estates, and trusts to be other than on paper forms supplied by the Secretary.

"(2) REQUIREMENTS OF REGULATIONS.—In prescribing regulations under paragraph (1), the Secretary—

"(A) shall not require any person to file returns on magnetic media unless such person is required to file at least 250 returns during the calendar year, and

"(B) shall take into account (among other relevant factors) the ability of the taxpayer to comply at reasonable cost with the requirements of such regulations."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to returns the due date for which (determined without regard to extensions) is after December 31, 1989.

SEC. 7714. STUDY OF PROCEDURES TO PREVENT MISMATCHING.

(a) GENERAL RULE.—The Comptroller General (in consultation with the Secretary of the Treasury or his delegate) shall conduct a study on procedures to resolve, with the least disclosure of return information possible, discrepancies between taxpayer-identity information shown on information returns and such information in the records of the Internal Revenue Service.

(b) REPORT.—Not later than June 1, 1990, the Comptroller General shall submit to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate a report on the study conducted under subsection (a), together with such recommendations as hg may deem advisable.

SEC. 7715. STUDY OF SERVICE BUREAUS.

(a) GENERAL RULE.—The Comptroller General (in consultation with the Secretary of the Treasury or his delegate) shall conduct a study of whether persons engaged in the business of transmitting information returns or other documents to the Internal Revenue Service on behalf of other persons should be subject to registration or other regulation.

(b) REPORT.—Not later than July 1, 1990, the Comptroller General shall submit to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate a report on the study conducted under subsection (a), together with such recommendations as he may deem advisable.

PART II—REVISION OF ACCURACY-RELATED PENALTIES

SEC. 7721. REVISION OF ACCURACY-RELATED PENALTIES.

(a) GENERAL RULE.—Subchapter A of chapter 68 (relating to additions to the tax and additional amounts) is amended by striking section 6662 and inserting the following:

"PART II—ACCURACY-RELATED AND FRAUD PENALTIES

"Sec. 6662. Imposition of accuracy-related penalty.

"Sec. 6663. Imposition of fraud penalty.

"Sec. 6664. Definitions and special rules.

"SEC. 6662. IMPOSITION OF ACCURACY-RELATED PENALTY.

"(a) IMPOSITION OF PENALTY.—If this section applies to any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment to which this section applies.

"(b) PORTION OF UNDERPAYMENT TO WHICH SECTION APPLIES.—This section shall apply to the portion of any underpayment which is attributable to 1 or more of the following:

"(1) Negligence or disregard of rules or regulations.

"(2) Any substantial understatement of income tax.

"(3) Any substantial valuation overstatement under chapter 1.

"(4) Any substantial overstatement of pension liabilities.

"(5) Any substantial estate or gift tax valuation understatement.

This section shall not apply to any portion of an underpayment on which a penalty is imposed under section 6663.

"(c) NEGLIGENCE.—For purposes of this section, the term 'negligence' includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term 'disregard' includes any careless, reckless, or intentional disregard.

"(d) SUBSTANTIAL UNDERSTATEMENT OF INCOME TAX.—

"(1) SUBSTANTIAL UNDERSTATEMENT.—

"(A) IN GENERAL.—For purposes of this section, there is a substantial understatement of income tax or any taxable year if the amount of the understatement for the taxable year exceeds the greater of—

"(i) 10 percent of the tax required to be shown on the return for the taxable year, or

"(ii) $5,000.

"(B) SPECIAL RULE FOR CORPORATIONS.—In the case of a corporation other than an S corporation or a personal holding company (as defined in section 542), paragraph (1) shall be applied by substituting "$10,000" for "$5,000".

"(2) UNDERSTATEMENT.—

"(A) IN GENERAL.—For purposes of paragraph (1), the term 'understatement' means the excess of—

"(i) the amount of the tax required to be shown on the return for the taxable year, over

"(ii) the amount of the tax imposed which is shown on the return, reduced by any rebate (within the meaning of section 6211(b)(2)).

"(B) REDUCTION FOR UNDERSTATEMENT DUE TO POSITION OF TAXPAYER OR DISCLOSED ITEM.—The amount of the understatement under subparagraph (A) shall be reduced by that portion of the understatement which is attributable to—

"(i) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment, or

"(ii) any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return.

"(C) SPECIAL RULES IN CASES INVOLVING TAX SHELTERS.—

"(i) IN GENERAL.—In the case of any item attributable to a tax shelter—

"(I) subparagraph (B)(ii) shall not apply, and

"(II) subparagraph (B)(i) shall not apply unless (in addition to meeting the requirements of such subparagraph) the taxpayer reasonably believed that the tax treatment of such item by the taxpayer was more likely than not the proper treatment.

"(ii) TAX SHELTER.—For purposes of clause (i), the term 'tax shelter' means—

"(I) a partnership or other entity,

"(II) any investment plan or arrangement, or

"(III) any other plan or arrangement,

if the principal purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.

"(D) SECRETARIAL LIST.—The Secretary shall prescribe (and revise not less frequently than annually) a list of positions—

"(i) for which the Secretary believes there is not substantial authority, and

"(ii) which affect a significant number of taxpayers.

Such list (and any revision thereof) shall be published in the Federal Register.

"(e) SUBSTANTIAL VALUATION OVERSTATEMENT UNDER CHAPTER 1.—

"(1) IN GENERAL.—For purposes of this section, there is a substantial valuation overstatement under chapter 1 if the value of any property (or the adjusted basis of any property) claimed on any return of tax imposed by chapter 1 is 200 percent or more of the amount determined to be the correct amount of such valuation or adjusted basis (as the case may be).

"(2) LIMITATION.—No penalty shall be imposed by reason of subsection (b)(3) unless the portion of the underpayment for the taxable year attributable to substantial valuation overstatements under chapter 1 exceeds $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company (as defined in section 542)).

"(f) SUBSTANTIAL OVERSTATEMENT OF PENSION LIABILITIES.—

"(1) IN GENERAL.—For purposes of this section, there is a substantial overstatement of pension liabilities if the actuarial determination of the liabilities taken into account for purposes of computing the deduction under paragraph (1) or (2) of section 404(a) is 200 percent or more of the amount determined to be the correct amount of such liabilities.

"(2) LIMITATION.—No penalty shall be imposed by reason of subsection (b)(4) unless the portion of the underpayment for the taxable year attributable to substantial overstatements of pension liabilities exceeds $1,000.

"(g) SUBSTANTIAL ESTATE OR GIFT TAX VALUATION UNDERSTATEMENT.—

"(1) IN GENERAL.—For purposes of this section, there is a substantial estate or gift tax valuation understatement if the value of any property claimed on any return of tax imposed by subtitle B is 50 percent or less of the amount determined to be the correct amount of such valuation.

"(2) LIMITATION.—No penalty shall be imposed by reason of subsection (b)(5) unless the portion of the underpayment attributable to substantial estate or gift tax valuation understatements for the taxable period (or, in the case of the tax imposed by chapter 11, with respect to the estate of the decedent) exceeds $5,000.

"(h) INCREASE IN PENALTY IN CASE OF GROSS VALUATION MISSTATEMENTS.—

"(1) IN GENERAL.—To the extent that a portion of the underpayment to which this section applies is attributable to one or more gross valuation misstatements, subsection (a) shall be applied with respect to such portion by substituting '40 percent' for '20 percent'.

"(2) GROSS VALUATION MISSTATEMENTS.—The term 'gross valuation misstatements' means—

"(A) any substantial valuation overstatement under chapter 1 as determined under subsection (e) by substituting '400 percent' or '200 percent'.

"(B) any substantial overstatement of pension liabilities as determined under subsection (f) by substituting '400 percent' for '200 percent', and

"(C) any substantial estate or gift tax valuation understatement as determined under subsection (g) by substituting '25 percent' for '50 percent'.

"SEC. 6663. IMPOSITION OF FRAUD PENALTY.

"(a) IMPOSITION OF PENALTY.—If any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment which is attributable to fraud.

"(b) DETERMINATION OF PORTION ATTRIBUTABLE TO FRAUD.—If the Secretary establishes that any portion of an underpayment is attributable to fraud, the entire underpayment shall be treated as attributable to fraud, except with respect to any portion of the underpayment which the taxpayer establishes (by a preponderance of the evidence) is not attributable to fraud.

"(c) SPECIAL RULE FOR JOINT RETURNS.—In the case of a joint return, this section shall not apply with respect to a spouse unless some part of the underpayment is due to the fraud of such spouse.

"SEC. 6664. DEFINITIONS AND SPECIAL RULES.

"(a) UNDERPAYMENT.—For purposes of this part, the term 'underpayment' means the amount by which any tax imposed by this title exceeds the excess of—

"(1) the sum of—

"(A) the amount shown as the tax by the taxpayer on his return, plus

"(B) amounts not so shown previously assessed (or collected without assessment), over

"(2) the amount of rebates made.

For purposes of paragraph (2), the term 'rebate' means so much of an abatement, credit, refund, or other repayment, as was made on the ground that the tax imposed was less than the excess of the amount specified in paragraph (1) over the rebates previously made.

"(b) PENALTIES APPLICABLE ONLY WHERE RETURN FILED.—The penalties provided in this part shall apply only in cases where a return of tax is filed (other than a return prepared by the Secretary under the authority of section 6020(b)).

"(c) REASONABLE CAUSE EXCEPTION.—

"(1) IN GENERAL.—No penalty shall be imposed under this part with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.

"(2) SPECIAL RULE FOR CERTAIN VALUATION OVERSTATEMENTS.—In the case of any underpayment attributable to a substantial or gross valuation overstatement under chapter 1 with respect to charitable deduction property, paragraph (1) shall not apply unless—

"(A) the claimed value of the property was based on a qualified appraisal made by a qualified appraiser, and

"(B) in addition to obtaining such appraisal, the taxpayer made a good faith investigation of the value of the contributed property.

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) CHARITABLE DEDUCTION PROPERTY.—The term 'charitable deduction property' means any property contributed by the taxpayer in a contribution for which a deduction was claimed under section 170. For purposes of paragraph (2), such term shall not include any securities for which (as of the date of the contribution) market quotations are readily available on an established securities market.

"(B) QUALIFIED APPRAISER.—The term 'qualified appraiser' means any appraiser meeting the requirements of the regulations prescribed under section 170(a)(1).

"(C) QUALIFIED APPRAISAL.—The term 'qualified appraisal' means any appraisal meeting the requirements of the regulations prescribed under section 170(a)(1).

"PART III—APPLICABLE RULES

"Sec. 6665. Applicable rules.

"SEC. 6665. APPLICABLE RULES.

"(a) ADDITIONS TREATED AS TAX.—Except as otherwise provided in this title—

"(1) the additions to the tax, additional amounts, and penalties provided by this chapter shall be paid upon notice and demand and shall be assessed, collected, and paid in the same manner as taxes; and

"(2) any reference in this title to 'tax' imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter.

"(b) PROCEDURE FOR ASSESSING CERTAIN ADDITIONS TO TAX.—For purposes of subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes), subsection (a) shall not apply to any addition to tax under section 6651, 6654, or 6655; except that it shall apply—

"(1) in the case of an addition described in section 6651, to that portion of such addition which is attributable to a deficiency in tax described in section 6211; or

"(2) to an addition described in section 6654 or 6655, if no return is filed for the taxable year."

(b) REPEAL OF INCREASE IN INCREASE ON CERTAIN SUBSTANTIAL UNDERPAYMENTS.—Subsection (c) of section 6621 (relating to interest on substantial underpayments attributable to tax motivated transactions) is hereby repealed.

(c) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Section 6653 is amended to read as follows:

"SEC. 6653. FAILURE TO PAY STAMP TAX.

"Any person (as defined in section 6671(b)) who—

"(1) willfully fails to pay any tax imposed by this title which is payable by stamp, coupons, tickets, books, or other devices or methods prescribed by this title or by regulations under the authority of this title, or

"(2) willfully attempts in any manner to evade or defeat any such tax or the payment thereof,

shall, in addition to other penalties provided by law, be liable for a penalty of 50 percent of the total amount of the underpayment of the tax."

(2) Sections 6659, 6659A, 6660, and 6661 are hereby repealed.

(3) Subsection (b) of section 5684 is amended—

(A) by striking "6662(a)" and inserting "6665(a)", and

(B) by striking "6662" in the subsection heading and inserting "6665".

(4) Subsection (a) of section 5761 is amended by striking "or 6653" and inserting "or 6653 or part II of subchapter A of chapter 68".

(5) Subsection (c) of section 5761 is amended—

(A) by striking "6662(a)" and inserting "6665(a)", and

(B) by striking "6662" in the subsection heading and inserting "6665".

(6) Subparagraph (A) of section 6013(b)(5) is amended—

(A) by striking "section 6653" and inserting "part II of subchapter A of chapter 68", and

(B) by striking **"SECTION 6653"** in the subparagraph heading and inserting **"PART II OF SUBCHAPTER A OF CHAPTER 68"**.

(7) Subsection (d) of section 6222 is amended by striking "section 6653(a)" and inserting "part II of subchapter A of chapter 68".

(8) Paragraph (2) of section 6601(e) is amended by striking "section 6651(a)(1), 6653, 6659, 6660, or 6661" each place it appears and inserting "section 6651(a)(1) or 6653 or under part II of subchapter A of chapter 68".

(9) Subsection (a) of section 6672 is amended by striking "under section 6653" and inserting "under section 6653 or part II of subchapter A of chapter 68".

(10) Subparagraph (C) of section 461(i)(3) is amended by striking "section 6662(b)(2)(C)(ii)" and inserting "section 6662(d)(2)(C)(ii)".

(11) Clause (i) of section 1274(b)(3)(B) is amended by striking "section 6661(b)(2)(C)(ii)" and inserting "section 6662(d)(2)(C)(ii)".

(12) Subparagraph (B) of section 7519(f)(4) is amended by striking "section 6653" and inserting "part II of subchapter A of chapter 68".

(13) Subchapter A of chapter 68 is amended by inserting after the subchapter heading the following:

"Part I. General provisions.

"Part II. Accuracy-related and fraud penalties.

"Part III. Applicable rules.

"PART I—GENERAL PROVISIONS".

(14) The table of sections for part I of subchapter A of chapter 68 (as amended by paragraph (1)) is amended—

(A) by striking out the items relating to sections 6659, 6659A, 6660, and 6661, and

(B) by striking the item relating to section 6653 and inserting:

"Sec. 6653. Failure to pay stamp tax."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to returns the due date for which (determined without regard to extensions) is after December 31, 1989.

PART III—PREPARER, PROMOTER, AND PROTESTER PENALTIES

SEC. 7731. PENALTY FOR INSTITUTING PROCEEDINGS BEFORE TAX COURT PRIMARILY FOR DELAY, ETC.

(a) GENERAL RULE.—Section 6673 (relating to damages assessable for instituting proceedings before the Tax Court primarily for delay, etc.) is amended to read as follows:

"SEC. 6673. SANCTIONS AND COSTS AWARDED BY COURTS.

"(a) TAX COURT PROCEEDINGS.—

"(1) PROCEEDINGS INSTITUTED PRIMARILY FOR DELAY, ETC.—Whenever it appears to the Tax Court that—

"(A) proceedings before it have been instituted or maintained by the taxpayer primarily for delay,

"(B) the taxpayer's position in such proceeding is frivolous or groundless, or

"(C) the taxpayer unreasonably failed to pursue available administrative remedies,

the Tax Court, in its decision, may require the taxpayer to pay to the United States a penalty not in excess of $25,000.

"(2) COUNSEL'S LIABILITY FOR EXCESSIVE COSTS.—Whenever it appears to the Tax Court that any attorney or other person admitted to practice before the Tax Court has multiplied the proceedings in

any case unreasonably and vexatiously, the Tax Court may require—

"(A) that such attorney or other person pay personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct, or

"(B) if such attorney is appearing on behalf of the Commissioner of Internal Revenue, that the United States pay such excess costs, expenses, and attorneys' fees in the same manner as such an award by a district court.

"(b) PROCEEDINGS IN OTHER COURTS.—

"(1) CLAIMS UNDER SECTION 7433.—Whenever it appears to the court that the taxpayer's position in the proceedings before the court instituted or maintained by such taxpayer under section 7433 is frivolous or groundless, the court may require the taxpayer to pay to the United States a penalty not in excess of $10,000.

"(2) COLLECTION OF SANCTIONS AND COSTS.—In any civil proceeding before any court (other than the Tax Court) which is brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, any monetary sanctions, penalties, or costs awarded by the court to the United States may be assessed by the Secretary and, upon notice and demand, may be collected in the same manner as a tax.

"(3) SANCTIONS AND COSTS AWARDED BY A COURT OF APPEALS.—In connection with any appeal from a proceeding in the Tax Court or a civil proceeding described in paragraph (2), an order of a United States Court of Appeals or the Supreme Court awarding monetary sanctions, penalties or court costs to the United States may be registered in a district court upon filing a certified copy of such order and shall be enforceable as other district court judgments. Any such sanctions, penalties, or costs may be assessed by the Secretary and, upon notice and demand, may be collected in the same manner as a tax."

(b) CLARIFICATION OF AUTHORITY TO IMPOSE PENALTIES BY APPELLATE COURTS.—Paragraph (4) of section 7482(c) (relating to power to impose damages) is amended to read as follows:

"(4) TO IMPOSE PENALTIES.—The United States Court of Appeals and the Supreme Court shall have the power to require the taxpayer to pay to the United States a penalty in any case where the decision of the Tax Court is affirmed and it appears that the appeal was instituted or maintained primarily for delay or that the taxpayer's position in the appeal is frivolous or groundless."

(c) CLERICAL AMENDMENT.—The table of sections for part I of subchapter B of chapter 68 is amended by striking the item relating to section 6673 and inserting the following:

"Sec. 6673. Sanctions and costs awarded by courts."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to positions taken after December 31, 1989, in proceedings which are pending on, or commenced after such date.

SEC. 7732. MODIFICATIONS TO PENALTIES ON RETURN PREPARERS FOR CERTAIN UNDERSTATEMENTS.

(a) GENERAL RULE.—Subsections (a) and (b) of section 6694 (relating to understatement of taxpayer's liability by income tax return preparer) are amended to read as follows:

"(a) UNDERSTATEMENTS DUE TO UNREALISTIC POSITIONS.—If—

"(1) any part of any understatement of liability with respect to any return or claim for refund is due to a position for which there was not a realistic possibility of being sustained on its merits,

"(2) any person who is an income tax return preparer with respect to such return or claim knew (or reasonably should have known) of such position, and

"(3) such position was not disclosed as provided in section 6662(d)(2)(B)(ii) or was frivolous,

such person shall pay a penalty of $250 with respect to such return or claim unless it is shown that there is reasonable cause for the understatement and such person acted in good faith.

"(b) WILLFUL OR RECKLESS CONDUCT.—If any part of any understatement of liability with respect to any return or claim for refund is due—

"(1) to a willful attempt in any manner to understate the liability for tax by a person who is an income tax return preparer with respect to such return or claim, or

"(2) to any reckless or intentional disregard of rules or regulations by any such person,

such person shall pay a penalty of $1,000 with respect to such return or claim. With respect to any return or claim, the amount of the penalty payable by any person by reason of this subsection shall be reduced by the amount of the penalty paid by such person by reason of subsection (a)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply with respect to documents prepared after December 31, 1989.

SEC. 7733. MODIFICATIONS TO OTHER ASSESSABLE PENALTIES WITH RESPECT TO RETURN PREPARERS.

(a) FAILURE TO FURNISH COPY TO TAXPAYER.—Subsection (a) of section 6695 is amended.—

(1) by striking "$25" and inserting "$50", and

(2) by adding at the end thereof the following new sentence: "The maximum penalty imposed under this subsection on any person with respect to documents filed during any calendar year shall not exceed $25,000."

(b) FAILURE TO SIGN RETURN.—Subsection (b) of section 6695 is amended—

(1) by striking "$25" and inserting "$50", and

(2) by adding at the end thereof the following new sentence: "The maximum penalty imposed under this subsection on any person with respect to documents filed during any calendar year shall not exceed $25,000."

(c) FAILURE TO FURNISH IDENTIFYING NUMBER.—Subsection (c) of section 6695 is amended—

(1) by striking "$25" and inserting "$50", and

(2) by adding at the end thereof the following new sentence: "The maximum penalty imposed under this subsection on any person with

respect to documents filed during any calendar year shall not exceed $25,000."

(d) FAILURE TO FILE CORRECT INFORMATION RETURNS.—Subsection (e) of section 6695 is amended to read as follows:

"(e) FAILURE TO FILE CORRECT INFORMATION RETURNS.—Any person required to make a return under section 6060 who fails to comply with the requirements of such section shall pay a penalty of $50 for—

"(1) each failure to file a return as required under such section, and

"(2) each failure to set forth an item in the return as required under section,

unless it is shown that such failure is due to reasonable cause and not due to willful neglect. The maximum penalty imposed under this subsection on any person with respect to any return period shall not exceed $25,000."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to documents prepared after December 31, 1989.

SEC. 7734. MODIFICATIONS TO PENALTY FOR PROMOTING ABUSIVE TAX SHELTERS, ETC.

(a) GENERAL RULE.—Subsection (a) of section 6700 is amended—

(1) by inserting "(directly or indirectly)" after "participates" in paragraph (1)(B),

(2) by inserting "or causes another person to make or furnish" after "makes or furnishes" in paragraph (2), and

(3) by striking the material following paragraph (2) and inserting the following:

"shall pay, with respect to each activity described in paragraph (1), a penalty equal to the $1,000 or, if the person establishes that it is lesser, 100 percent of the gross income derived (or to be derived) by such person from such activity. For purposes of the preceding sentence, activities described in paragraph (1)(A) with respect to each entity or arrangement shall be treated as a separate activity and participation in each sale described in paragraph (1)(B) shall be so treated."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to activities after December 31, 1989.

SEC. 7735. MODIFICATIONS TO PENALTIES FOR AIDING AND ABETTING UNDERSTATEMENT OF TAX LIABILITY.

(a) GENERAL RULE.—Subsection (a) of section 6701 (relating to penalties for aiding and abetting understatement of tax liability) is amended—

(1) by striking "in connection with any matter arising under the internal revenue laws" in paragraph (1),

(2) by striking "who knows" in paragraph (2) and inserting "who knows (or has reason to believe)", and

(3) by striking "will result" in paragraph (3) and inserting "would result".

(b) COORDINATION WITH PENALTY UNDER SECTION 6700.—

(1) IN GENERAL.—Subsection (f) of section 6701 is amended by adding at the end thereof the following new paragraph:

"(3) COORDINATION WITH SECTION 6700.—No penalty shall be assessed under section 6700 on any person with respect to any document for which a penalty is assessed on such person under subsection (a)."

"(2) TECHNICAL AMENDMENT.—Paragraph (1) of section 6701(f) is amended by striking "paragraph (2)" and inserting "paragraphs (2) and (3)".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on December 31, 1989.

SEC. 7736. MODIFICATION TO PENALTY FOR FRIVOLOUS INCOME TAX RETURN.

(a) REQUIREMENT OF FULL PAYMENT OF PENALTY.—Subsection (c) of section 6703 is amended by striking "section 6700, 6701, or 6702" each place it appears and inserting "section 6700 or 6701".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to returns filed after December 31, 1989.

SEC. 7737. AUTHORITY TO COUNTERCLAIM FOR BALANCE OF PENALTY IN PARTIAL REFUND SUITS.

(a) GENERAL RULE.—Sections 6672(b)(1), 6694(c)(1), and 6703(c)(1) are each amended by adding at the end thereof the following new sentence: "Nothing in this paragraph shall be construed to prohibit any counterclaim for the remainder of such penalty in a proceeding begun as provided in paragraph (2)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 7738. REPEAL OF BONDING REQUIREMENT UNDER SECTION 7407.

(a) GENERAL RULE.—Subsection (c) of section 7407 (relating to bond to stay injunction) is hereby repealed.

(b) CONFORMING AMENDMENT.—Subsection (a) of section 7407 is amended by striking "Except as provided in subsection (c), a civil" and inserting "A civil".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to actions commenced after December 31, 1989.

SEC. 7739. CERTAIN DISCLOSURES OF INFORMATION BY PREPARERS PERMITTED.

(a) GENERAL RULE.—Paragraph (3) of section 7216(b) (relating to exceptions) is amended by adding at the end thereof the following new sentence: "Such regulations shall permit (subject to such conditions as such regulations shall provide) the disclosure or use of information for quality or peer reviews."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

PART IV— FAILURES TO FILE OR PAY

SEC. 7741. INCREASE IN PENALTY FOR FRAUDULENT FAILURE TO FILE.

(a) GENERAL RULE.—Section 6651 (relating to failure to file tax return or pay tax) is amended by adding at the end thereof the following new subsection:

"(f) INCREASE IN PENALTY FOR FRAUDULENT FAILURE TO FILE.—If any failure to file any return is fraudulent, paragraph (1) of subsection (a) shall be applied—

"(1) by substituting '15 percent' for '5 percent' each place it appears, and

"(2) by substituting '75 percent' for '25 percent'."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply in the case of failures to file returns the due date for which (determined without regard to extensions) is after December, 31, 1989.

SEC. 7742. FAILURE TO MAKE DEPOSIT OF TAXES.

(a) GENERAL RULE.—Section 6656 (relating to failure to make deposit of taxes or overstatement of deposits) is amended to read as follows:

"SEC. 6656. FAILURE TO MAKE DEPOSIT OF TAXES.

"(a) UNDERPAYMENT OF DEPOSITS.—In the case of any failure of any person to deposit (as required by this title or by regulations of the Secretary under this title) on the date prescribed therefor any amount of tax imposed by this title in such government depository as is authorized under section 6302(c) to receive such deposit, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be imposed upon such person a penalty equal to the applicable percentage of the amount of the underpayment.

"(b) DEFINITIONS.—For purposes of subsection (a)—

"(1) APPLICABLE PERCENTAGE.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'applicable percentage' means—

"(i) 2 percent if the failure is for not more than 5 days.

"(ii) 5 percent if the failure is for more than 5 days but not more than 15 days, and

"(iii) 10 percent if the failure is for more than 15 days.

"(B) SPECIAL RULE.—In any case where the tax is not deposited on or before the earlier of—

"(i) the day 10 days after the date of the first delinquency notice to the taxpayer under section 6303, or

"(ii) the day on which notice and demand for immediate payment is given under section 6861 or 6862 or the last sentence of section 6331(a),

the applicable percentage shall be 15 percent.

"(2) UNDERPAYMENT.—The term 'underpayment' means the excess of the amount of the tax required to be deposited over the amount, if any, thereof deposited on or before the date prescribed therefor."

(b) CLERICAL AMENDMENT.—The table of sections for part I of subchapter A of chapter 68 (as amended by title II) is amended by striking the item relating to section 6656 and inserting the following:

"Sec. 6656. Failure to make deposit of taxes."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to deposits required to be made after December 31, 1989.

SEC. 7743. EFFECT OF PAYMENT OF TAX BY RECIPIENT ON CERTAIN PENALTIES.

(a) GENERAL RULE.—Section 1463 (relating to tax paid by recipient of income) is amended to read as follows:

"SEC. 1463. TAX PAID BY RECIPIENT OF INCOME.

"If—

"(1) any person, in violation of the provisions of this chapter, fails to deduct and withhold any tax under this chapter, and

"(2) thereafter the tax against which such tax may be credited is paid,

the tax so required to be deducted and withheld shall not be collected from such person; but this subsection shall in no case relieve such person from liability for interest or any penalties or additions to the tax otherwise applicable in respect of such failure to deduct and withhold."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to failures after December 31, 1989.

Subtitle H—Technical Corrections

SEC. 7801. DEFINITIONS; COORDINATION WITH OTHER SUBTITLES.

(a) DEFINITIONS.—For purposes of this subtitle—

(1) 1988 ACT.—The term "1988 Act" means the Technical and Miscellaneous Revenue Act of 1988.

(2) 1987 ACT.—The term "1987 Act" means the Revenue Act of 1987.

(b) COORDINATION WITH OTHER SUBTITLES.—For purposes of applying the amendments made by any subtitle of this title other than this subtitle, the provisions of this subtitle shall be treated as having been enacted immediately before the provisions of such other subtitles.

PART I—AMENDMENTS RELATED TO TECHNICAL AND MISCELLANEOUS REVENUE ACT OF 1988

SEC. 7811. AMENDMENTS RELATED TO TITLE I OF THE 1988 ACT.

(a) AMENDMENTS RELATED TO SECTION 1002 OF THE 1988 ACT.—

(1) The heading for subparagraph (C) of section 42(d)(5) is amended by inserting "SECTION" before "167(k)".

(2) Clause (ii) of section 42(h)(5)(D) is amended by striking "clause (ii)" and inserting "clause (i)".

(b) AMENDMENTS RELATED TO SECTION 1003 OF THE 1988 ACT.—

(1) Subparagraph (C) of section 643(a)(6) is amended by striking "(i)" and by striking ", and (ii)" and all that follows and inserting a period.

(2) Paragraph (6) of section 643(a) is amended by striking subparagraph (D).

(c) AMENDMENTS RELATED TO SECTION 1006 OF THE 1988 ACT.—

(1) Subparagraphs (C) and (D) of section 26(b)(2) are amended to read as follows:

"(C) subsection (m)(5)(B), (q), (t), or (v) of section 72 (relating to additional taxes on certain distributions),

"(D) section 143(m) (relating to recapture of proration of Federal subsidy from use of mortgage bonds and mortgage credit certificates),".

(2) Paragraph (2) of section 26(b) is amended by striking subparagraph (K) and all that folows and inserting the following new subparagraphs:

"(K) sections 871(a) and 881 (relating to certain income of

nonresident aliens and foreign corporations),

"(L) section 860E(e) (relating to taxes with respect to certain residual interests), and

"(M) section 884 (relating to branch profits tax)."

(3) Subparagraph (B) of section 6724(d)(1) is amended by striking clause (viii) and all that follows and inserting the following:

"(viii) section 6052(a) (relating to reporting payment of wages in the form of group-term life insurance),

"(ix) section 6053(c)(1) (relating to reporting with respect to certain tips),

"(x) section 1060(b) (relating to reporting requirements of transferors and transferees in certain asset acquisitions), or

"(xi) subparagraph (A) or (C) of subsection (c)(4), or subsection (e), of section 4093 (relating to information reporting with respect to tax on diesel and aviation fuel)."

(4) Clause (i) of section 1374(d)(2)(A) is amended by striking "(except as provided in subsection (b)(2))".

(5)(A) Paragraph (6) of section 382(h) is amended)—

(i) by striking "during the recognition period" in subparagraph (B) and inserting "during the recognition period (determined without regard to any carryover)", and

(ii) by striking "treated as recognized built-in gains or losses under this paragraph" in subparagraph (C) and inserting "which would be treated as recognized built-in gains or losses under this paragraph if such amounts were properly taken into account (or allowable as a deduction) during the recognition period".

(B) Paragraph (5) of section 1374(d) is amended—

(i) by striking "during the recognition period" in subparagraph (B) and inserting "during the recognition period (determined without regard to any carryover)", and

(ii) by striking "treated as recognized built-in gains or losses under this paragraph" in subparagraph (C) and inserting "which would be treated as recognized built-in gains or losses under this paragraph if such amounts were properly taken into account (or allowable as a deduction) during the recognition period".

(6) Subparagraph (B) of section 1361(b)(2) is amended to read as follows:

"(B) a financial institution to which section 585 applies (or would apply but for subsection (c) thereof) or to which section 593 applies,".

(7) Paragraph (2) of section 1366(f) is amended to read as follows:

"(2) TREATMENT OF TAX IMPOSED ON BUILT-IN GAINS.—If any tax is imposed under section 1374 for any taxable year on an S corporation, for purposes of subsection (a), the amount so imposed shall be treated as a loss sustained by the S corporation during such taxable year. The character of such loss shall be determined by allocating the loss proportionately among the recognized built-in gains giving rise to such tax."

(8) Subparagraph (B) of section 1374(b)(3) is amended by adding at the end the following new sentence: "A similar rule shall apply in the case of the minimum tax credit under section 53 to the extent attributable to taxable years for which the corporation was a C corporation."

(9) The last sentence of section 860G(a)(3) is amended by striking "this subparagraph" and inserting "subparagraph (A)".

(d) AMENDMENTS RELATED TO SECTION 1007 OF THE 1988 ACT.—

(1)(A) Subsection (g) of section 59 is amended by striking "for any taxable year" and inserting "for the taxable year for which the item is taken into account or for any other taxable year".

(B) The repeal of section 58(h) of the Internal Revenue Code of 1954 by the Tax Reform Act of 1986 shall be effective only with respect to items of tax preference arising in taxable years beginning after December 31, 1986.

(2) Subclause (II) of section 53(d)(1)(B)(i) is amended by inserting before the period at the end of the following: "and if section 59(a)(2) did not apply".

(3) Paragraph (3) of section 56(b) is amended—

(A) by inserting after the first sentence the following new sentence: "Section 422A(c)(2) shall apply in any case where the disposition and the inclusion for purposes of this part are within the same taxable year and such section shall not apply in any other case.", and

(B) by striking "the preceding sentence" and inserting "this" paragraph".

(e) AMENDMENTS RELATED TO SECTION 1008 OF THE 1988 ACT.—

(1) Paragraph (2) of section 460(a) is amended by inserting "(or, with respect to any amount properly taken into account after completion of the contract, when such amount is so properly taken into account)" after "any long-term contract".

(2) Subparagraph (B) of section 460(b)(2) is amended—

(A) by striking "any amount received or accrued" and inserting "any amount properly taken into account", and

(B) by striking "is so received or accrued" and inserting "is so properly taken into account".

(3) Paragraph (3) of section 460(b) is amended—

(A) by striking "any amount received or accrued" in the second sentence and inserting "any amount properly taken into account", and

(B) by striking "such amount was received or accrued" in the second sentence and inserting "such amount was properly taken into account".

(4) Paragraph (2) of section 460(b) is amended by adding at the end the following new sentence: "In the case of any long-term contract with respect to which the percentage of completion method is used, except for purposes of applying the look-back method of paragraph (3), any income under the contract (to the extent not previously includible in gross income) shall be included in gross income for the taxable year following the taxable year in which the contract was completed."

(5) Paragraph (2) of section 460(e) is amended by striking "and" at the end of subparagraph (A), by inserting "and" at the end of subparagraph (B), and by inserting after subparagraph (B) the following new subparagraph:

"(C) any predecessor of the taxpayer or a person described in subparagraph (A) or (B),".

(6) Paragraph (2) of section 460(b) is amended by adding at the end of the following new sentence: "For purposes of subtitle F (other than sections 6654 and 6655), any interest required to be paid by the taxpayer under subparagraph (B) shall be treated as an increase in the tax imposed by this chapter for the taxable year in which the contract is completed (or, in the case of interest payable with respect to any amount properly taken into account after completion of the contract, for the taxable year in which the amount is so properly taken into account)."

(f) AMENDMENTS RELATED TO SECTION 1009 OF THE 1988 ACT.—

(1) Subparagraph (A) of section 643(a)(6) is amended by striking "section 265(l)" and inserting "section 265(a)(1)".

(2) Subparagraph (B) of section 1009(b)(3) of the 1988 Act is amended by striking "section 265(b)(3)(B)(iii)" and inserting "section 265(b)(3)(B)(i)(III)".

(g) AMENDMENT RELATED TO SECTION 1011 OF THE 1988 ACT.—

(1) Subsection (a) of section 401 is amended by moving paragraph (30) from the end and inserting it after paragraph (29).

(2) The last sentence of section 402(g)(3) is amended by inserting "involving a one-time irrevocable election" after "similar arrangement".

(3) The heading of sections 406(c) and 407(c) are each amended by striking "PURPOSES LIMITATION" and inserting "PURPOSES OF LIMITATION".

(4) Clause (iii) of section 457(d)(1)(A) is amended by striking the period at the end and inserting ",and".

(5) Subclause (I) of section 457(d)(2)(B)(i) is amended by adding "and" at the end.

(h) AMENDMENTS RELATED TO SECTION 1011B OF THE 1988 ACT.—

(1) Paragraph (5) of section 409(l) is amended by striking "the last sentence" and inserting "the second sentence".

(2) Subsection (a) of section 129 is amended by striking the sentence following paragraph (2)(C) and preceding subsection (b).

(3) Paragraph (1) of section 1011B(j) of the 1988 Act is amended by striking "401(a)(28)(B)" and inserting "401(a)(28)(B)(ii)".

(i) AMENDMENTS RELATED TO SECTION 1012 OF THE 1988 ACT.—

(1) Subparagraph (H) of section 904(d)(1) is amended by striking "qualified interest and carrying charges (as defined in section 245(c))" and inserting "interest or carrying charges (as defined in section 927(d)(1)) derived from a transaction which results in foreign trade income (as defined in section 923(b))".

(2) Sections 861(a)(6), 862(a)(6), 863(b)(2), and 863(b)(3) are each amended by striking "865(h)(1)" and inserting "865(i)(1)".

(3) Subparagraph (A) of section 954(c)(3) is amended—

(A) by striking "is created" in clause (i) and inserting "is a corporation created",

(B) by striking "from a related person" in clause (ii) and inserting "from a corporation which is a related person", and

(C) by adding at the end the following: "To the extent provided in regulations, payments made by a partnership with 1 or more corporate partners shall be treated as made by such corporate partners in proportion to their respective interests in the partnership."

(4) Paragraph (5) of section 1297(b) is amended—

(A) by inserting "STOCK" after "WHERE" in the paragraph heading,

(B) by striking "any disposition of" in subparagraph (A)(ii) and inserting "any distribution of", and

(C) by striking "treated as a disposition to" in subparagraph (A) and inserting "treated as a disposition by, or distribution to".

(5) Subparagraph (B) of section 1012(q)(1) of the 1988 Act is amended—

(A) by striking "1021(e)(2)(C)" and inserting "1021(c)(2)(C)", and

(B) by striking "823(b)(4)(C)" and inserting "832(b)(4)(C)".

(6)(A) Subparagraph (B) of section 1446(b)(2) is amended by striking "section 11(b)" and inserting "section 11(b)(1)".

(B) Paragraph (2) of section 1446(d) is amended to read as follows:

"(2) CREDIT TREATED AS DISTRIBUTED TO PARTNER.—Except as provided in regulations, a foreign partner's share of any withholding tax paid by the partnership under this section shall be treated as distributed to such partner by such partnership on the earlier of—

"(A) the day on which such tax was paid by the partnership, or

"(B) the last day of the partnership's taxable year for which such tax was paid."

(C) Subsection (f) of section 1446 is amended to read as follows:

"(f) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section, including—

"(1) regulations providing for the application of this section in the case of publicly traded partnerships, and "(2) regulations providing—

"(A) that, for purposes of section 6655, the withholding tax imposed under this section shall be treated as a tax imposed by section 11 and any partnership required to pay such tax shall be treated as a corporation, and

"(B) appropriate adjustments in applying section 6655 with respect to such withholding tax."

(7) Subsection (a) of section 988 is amended by inserting after the subsection heading the following: "Notwithstanding any other provision of this chapter—".

(8)(A) Subsection (b) of section 887 is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) EXCEPTION FOR CERTAIN INCOME TAXABLE IN POSSESSIONS.—The term 'United States source gross transportation income' does not include any income taxable in a possession of the United

States under the provisions of this title as made applicable in such possession."

(B) Paragraph (1) of section 887(b) is amended by striking "paragraph (2)" and inserting "paragraphs (2) and (3)".

(C) Subsection (b) of section 872 is amended by adding at the end the following new paragraph:

"(7) TREATMENT OF POSSESSIONS.—To the extent provided in regulations, a possession of the United States shall be treated as a foreign country for purposes of this subsection."

(D) Paragraph (4) of section 883(a) is amended by striking "(5) and (6)" and inserting "(5), (6), and (7)".

(9) Paragraph (4) of section 887(b) (as redesignated by paragraph (8) is amended by striking "transportation income" the first two places it appears and inserting "United States source gross transportation income".

(10) Subsection (a) of section 883 is amended by adding at the end the following new paragraph:

"(5) SPECIAL RULE FOR COUNTRIES WHICH TAX ON RESIDENCE BASIS.—For purposes of this subsection, there shall not be taken into account any failure of a foreign country to grant an exemption to a corporation organized in the United States if such corporation is subject to tax by such foreign country on a residence basis pursuant to provisions of foreign law which meets such standards (if any) as the Secretary may prescribe."

(11) Paragraph (2) of section 4371 is amended by striking ", unless the insurer is subject to tax under section 842(b)".

(12) Subsection (g) of section 995 is amended by striking "section 511" and inserting "section 511 (or any other person otherwise subject to tax under section 511)".

(13) Effective with respect to taxable years ending after the date of the enactment of this Act (or, at the election of the taxpayer, beginning after December 31, 1986), subsection (e) of section 402 is amended by adding at the end the following new paragraph:

"(7) COORDINATION WITH FOREIGN TAX CREDIT LIMITATIONS.—Subsections (a), (b), and (c) of section 904 shall be applied separately with respect to any lump sum distribution on which tax is imposed under paragraph (1), and the amount of such distribution shall be treated as the taxable income for purposes of such separate application."

(14) Paragraph (2)(A) of section 1012(1) of the 1988 Act is amended by striking "section 245" and inserting "section 245(a)".

(j) AMENDMENTS RELATED TO SECTION 1014 OF THE 1988 ACT.—

(1) The subparagraph (C) of section 1(i)(3) added by section 1014(e)(7) of the 1988 Act is redesignated as subparagraph (D).

(2) Paragraph (1) of section 2654(a) is amended by adding at the end the following new sentence: "The preceding shall be applied after any basis adjustment under section 1015 with respect to the transfer."

(3) Subsection (g) of section 642 is amended by inserting after the first sentence the following new sentence: "Rules similar to the rules of the preceding sentence shall apply to amounts which may be taken into account under 2621(a)(2) or 2622(b)."

(4) Paragraphs (1) and (3) of section 2642(b) are each amended by striking "a timely filed gift tax return required by section 6019" and inserting "a gift tax return filed on or before the date prescribed by section 6075(b)".

(5) Paragraph (1) of section 6654(1) is amended by striking "this subsection shall" and inserting "this section shall".

(6) Clause (ii) of section 6654(1)(2)(B) is amended by inserting before the period at the end of the following: "(or, if no will is admitted to probate, which is the trust primarily responsible for paying debts, taxes, and expenses of administration)".

(7) The heading for subparagraph (D) of section 59(j)(2) is amended by striking "OTHERS" and inserting "OTHER".

(k) AMENDMENTS RELATED TO SECTION 1015 OF THE 1988 ACT.—

(1) Paragraph (3) of section 1015(r) of the 1988 Act is amended by striking "section 6211" and inserting "section 6213".

(2) The last sentence of section 6502(a) is amended by striking "enforceable" and inserting "unenforceable".

(l) AMENDMENT RELATED TO SECTION 1016 OF THE 1988 ACT.—The subparagraph (E) of section 514(c)(9) added by section 1016 of the 1988 Act is redesignated as subparagraph (F).

(m) AMENDMENTS RELATED TO SECTION 1018 OF THE 1988 ACT.—

(1) The subsection (f) of section 2503 added by section 1018 of the 1988 Act is redesignated as subsection (g).

(2) Paragraph (4) of section 1018(d) of the 1988 Act is amended by inserting "the first place it appears" before "and inserting".

(3) Paragraph (20) of section 1018(u) of the 1988 Act is amended by striking "section 9507(b)" and inserting "section 9509(b)".

(4) Subparagraph (B) of section 72(q)(2) is amended by striking "subsection (s)(6)(B))" and inserting "subsection (s)(6)(B)))".

(5) Paragraph (10) of section 414(p) is amended by inserting "section" before "403(b)".

(6) Paragraph (2) of section 1018(1) of the 1988 Act is amended by striking "paragraph (2) and (3)" and inserting "paragraphs (2) and (3)".

(7) Subsections (a)(6) and (b)(3) of section 408 are each amended by striking "(without regard to subparagraph (C)(ii) thereof)".

SEC. 7812. AMENDMENTS RELATED TO TITLE II OF THE 1988 ACT.

(a) AMENDMENT RELATED TO SECTION 2001 OF THE 1988 ACT.—Subparagraph (C) of section 2001(d)(7) of the 1988 Act is amended by striking "section 6427(g)(1)" and inserting "section 6427(f)(1)".

(b) AMENDMENT RELATED TO SECTION 2002 OF THE 1988 ACT.—Subsection (d) of section 2002 of the 1988 Act is amended by striking "this section" and inserting "subsections (b) and (c)" and by inserting before the period ", and the amendment made by subsection (a)(2) shall take effect as if included in the amendment made by section 521(a)(3) of the Superfund Revenue Act of 1986".

(c) AMENDMENTS RELATED TO SECTION 2004 OF THE 1988 ACT.—

(1) Paragraph (1) of section 384(e) is amended by striking "build-in gain" and inserting "built-in gain".

(2) Paragraph (3) of section 453A(c) is amended by striking "(5)." and inserting "(5))."

(d) AMENDMENT RELATED TO SECTION 2005 OF THE 1988 ACT.—Section 2005(e) of the 1988 Act is amended by inserting before the period ", except that the amendment made by subsection (a)(1) shall take effect as if included in the amendment made by section 1131(c) of the Tax Reform Act of 1986".

SEC. 7813. AMENDMENTS RELATED TO TITLE III OF THE 1988 ACT.

(a) AMENDMENT RELATED TO SECTION 3001 OF THE 1988 ACT.—Paragraph (2) of section 6724(b) is amended by redesignating subparagraph (U) as subparagraph (S), by striking "or" at the end of subparagraph (Q), and by striking the period at the end of subparagraph (R) and inserting ", or".

(b) AMENDMENTS RELATED TO SECTION 3011 OF THE 1988 ACT.—Paragraphs (4) and (5) of section 3011(b) of the 1988 Act are each amended—

(1) by striking "111B(a)" and inserting "1011B(a)", and

(2) by striking "162(k)(2)" and inserting "162(k)".

SEC. 7814. AMENDMENTS RELATED TO TITLE IV OF THE 1988 ACT.

(a) AMENDMENT RELATED TO SECTION 4001 OF THE 1988 ACT.—Subsection (c) of section 127 is amended by striking paragraph (8).

(b) AMENDMENT RELATED TO SECTION 4002 OF THE 1988 ACT.—Subparagraph (A) of section 125(e)(2) is amended by striking "includable" and inserting "includible".

(c) AMENDMENTS RELATED TO SECTION 4005 OF THE 1988 ACT.—

(1) The paragraph (3) of section 6045(e) added by section 4005 of the 1988 Act is redesignated as paragraph (4).

(2) Clause (ii) of section 148(d)(3)(E) is amended by striking "a qualified mortgage bond or".

(d) AMENDMENT RELATED TO SECTION 4006 OF THE 1988 ACT.—Section 4006 of the 1988 Act is amended—

(1) by striking "December 31, 1988" and inserting "Dec. 31, 1988", and

(2) by striking "December 31, 1989" and inserting "Dec. 31, 1989".

(e) AMENDMENTS RELATED TO SECTION 4008 OF THE 1988 ACT.—

(1) Subsection (d) of section 196 is amended by striking "substituting" and all that follows through "in the case of—" and inserting "substituting 'an amount equal to 50 percent of' for 'an amount equal to' in the case of—".

(2)(A) Subsection (c) of section 280C is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) ELECTION OF REDUCED CREDIT.—

"(A) IN GENERAL.—In the case of any taxable year for which an election is made under this paragraph—

"(i) paragraphs (1) and (2) shall not apply, and

"(ii) the amount of the credit under section 41(a) shall be the amount determined under subparagraph (B).

"(B) AMOUNT OF REDUCED CREDIT.—The amount of credit determined under this subparagraph for any taxable year shall be the amount equal to the excess of—

"(i) the amount of credit determined under section 41(a) without regard to this paragraph, over

"(ii) the product of—

"(I) 50 percent of the amount described in clause (i), and

"(II) the maximum rate of tax under section 11(b)(1).

"(C) ELECTION.—An election under this paragraph for any taxable year shall be made not later than the time for filing the return of tax for such year (including extensions), shall be made on such return, and shall be made in such manner as the Secretary may prescribe. Such an election, once made, shall be irrevocable."

(B) In the case of a taxable year for which the last date for making the election under section 280C(c)(3) of the Internal Revenue Code of 1986 (as added by subparagraph (A)) is on or before the date which is 75 days after the date of the enactment of this Act, such an election for such year may be made—

(i) at any time before the date which is 75 days after such date of enactment, and

(ii) in such form and manner as the Secretary of the Treasury or his delegate may prescribe.

(C) Section 41 is amended by striking subsection (h) and by redesignating subsection (i) as subsection (h).

(D) Paragraph (4) of section 196(c) is amended by inserting "(other than such credit determined under section 280C(c)(3))" after section 41(a)".

(E) Subsection (n) of section 6501 is amended by striking ", 41(h),".

(f) AMENDMENT RELATED TO SECTION 4011 OF THE 1988 ACT.—Subsection (c) of section 67 is amended by striking paragraph (4).

SEC. 7815. AMENDMENTS RELATED TO TITLE V OF THE 1988 ACT.

(a) AMENDMENTS RELATED TO SECTION 5012 OF THE 1988 ACT.—

(1) Subparagraph (B) of section 7702A(c)(3) is amended to read as follows:

"(B) TREATMENT OF CERTAIN BENEFIT INCREASES.—For purposes of subparagraph (A), the term 'material change' includes any increase in the death benefit under the contract or any increase in, or addition of, a qualified additional benefit under the contract. Such term shall not include—

"(i) any increase which is attributable to the payment of premiums necessary to fund the lowest level of the death benefit and qualified additional benefits payable in the 1st 7 contract years (determined after taking into account death benefit increases described in subparagraph (A) or (B) of

section 7702(e)(2)) or to crediting of interest or other earnings (including policyholder dividends) in respect of such premiums, and

"(ii) to the extent provided in regulations, any cost-of-living increase based on an established broad-based index if such increase is funded ratably over the remaining period during which premiums are required to be paid under the contract."

(2) Paragraph (2) of section 5012(e) of the 1988 Act is amended by striking "continues to make level annual premium payments over the life of the contract" and inserting "makes at least 7 level annual premium payments".

(3) Subparagraph (A) of section 72(e)(11) is amended by adding at the end of the following new sentence: "The preceding sentence shall not apply to any contract described in paragraph (5)(D)."

(4) Paragraph (4) of section 7702A(c) is amended—

(A) by striking "UNDER $10,000" in the paragraph heading and inserting "OF $10,000 OR LESS", and

(B) by strifking "the same insurer" and inserting "the same policyholder".

(5) Section 72(e)(11)(A) is amended by striking "12-month period" and inserting "calendar year".

(b) AMENDMENT RELATED TO SECTION 5021 OF THE 1988 ACT.—Subsection (e) of section 5021 of the 1988 Act is amended by striking "no provision in any law (whether enacted before, on, or after the date of the enactment of this Act)" and inserting "no provision in any law enacted after the date of the enactment of this Act".

(c) AMENDMENT RELATED TO SECTION 5032 OF THE 1988 ACT.—Subsection (b) of section 2101 is amended by adding at the end the following new sentence: "For purposes of the preceding sentence, there shall be appropriate adjustments in the application of section 2001(c)(3) to reflect the difference between the amount of the credit provided under section 2102(c) and the amount of the credit provided under section 2010."

(d) AMENDMENTS RELATED TO SECTION 5033 OF THE 1988 ACT.—

(1)(A) Paragraph (2) of section 2523(i) is amended by striking "made by the donor to such spouse" and inserting "which are made by the donor to such spouse and with respect to which a deduction would be allowable under this section but for paragraph (1)".

(B) The amendment made by subparagraph (A) shall apply with respect to gifts made after June 29, 1989.

(2) Subsection (a) of section 2523 is amended by striking "who is a citizen or resident".

(3) Paragraph (3) of section 2106(a) is amended by striking "ALLOWED WHERE SPOUSE IS CITIZEN".

(4)(A) Subparagraph (B) of section 2056(d)(2) is amended to read as follows:

"(B) SPECIAL RULE.—If any property passes from the decedent to the surviving spouse of the decedent, for purposes of subparagraph (A), such property shall be treated as passing to such spouse in a qualified domestic trust if—

"(i) such property is transferred to such a trust before the date on which the return of the tax imposed by this chapter is made, or

"(ii) such property is irrevocably assigned to such a trust under an irrevocable assignment made on or before such date which is enforceable under local law."

(B) In the case of the estate of a decedent dying before the date of the enactment of this Act, the period during which the transfer (or irrevocable assignment) referred to in section 2056(d)(2)(B) of the Internal Revenue Code of 1986 (as amended by subparagraph (A)) may be made shall not expire before the date 1 year after such date of enactment.

(5) Subsection (d) of section 2056 is amended by adding at the end the following new paragraph:

"(4) SPECIAL RULE WHERE RESIDENT SPOUSE BECOMES CITIZEN.—Paragraph (1) shall not apply if—

"(A) the surviving spouse of the decedent becomes a citizen of the United States before the day on which the return of the tax imposed by this chapter is made, and

"(B) such spouse was a resident of the United States at all times after the date of the death of the decedent and before becoming a citizen of the United States."

(6) Paragraph (3) of section 2056(d) is amended—

(A) by striking "section 2001" and inserting "this chapter", and

(B) by inserting before the period at the end of the following: "and without regard to subsection (d)(3) of such section".

(7)(A) Subsection (a) of section 2056A is amended—

(i) by amending paragraph (1) to read as follows:

"(1) the trust instrument requires that at least 1 trustee of the trust be an individual citizen of the United States or a domestic corporation and that no distribution from the trust may be made without the approval of such a trustee," ,and

(ii) by striking paragraph (2) and redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively.

(B) Subsection (b) of section 2056A is amended by redesignating paragraphs (3) through (8) as paragraphs (4) through (9), respectively, and by inserting after paragraph (2) the following new paragraph:

"(3) CERTAIN LIFETIME DISTRIBUTIONS EXEMPT FROM TAX.—

"(A) INCOME DISTRIBUTIONS.—No tax shall be imposed by paragraph (1)(A) on any distribution of income to the surviving spouse.

"(B) HARDSHIP EXEMPTION.—No tax shall be imposed by paragraph (1)(A) on any distribution to the surviving spouse on account of hardship."

(C) Subparagraph (A) of section 2056A(b)(1) is amended by striking "other than a distribution of income required under subsection (a)(2)".

(D) Paragraph (4) of section 2056A(b) (as redesignated by subparagraph (B)) is amended to read as follows:

"(4) TAX WHERE TRUST CEASES TO QUALIFY.—If any qualified domestic trust ceases to meet the requirements of paragraphs (1) and

(2) of subsection (a), the tax imposed by paragragh (1) shall apply as if the surviving spouse died on the date of such cessation."

(8) Subsection (d) of section 2056 is amended by adding at the end the following new paragraph:

"(4) REFORMATIONS PERMITTED.—

(A) IN GENERAL.—In the case of any property with respect to which a deduction would be allowable under subsection (a) but for this subsection, the determination of whether a trust is a qualified domestic trust shall be made—

"(i) as of the date on which the return of the tax imposed by this chapter made, or

"(ii) if a judicial proceeding is commenced on or before the due date (determined with regard to extensions) for filing such return to change such trust into a trust which is a qualified domestic trust, as of the time when the changes pursuant to such proceeding are made.

"(B) STATUTE OF LIMITATIONS.—If a judicial proceeding described in subparagraph (A)(ii) is commenced with respect to any trust, the period for assessing any deficiency of tax attributable to any failure of such trust to be a qualified domestic trust shall not expire before the date 1 year after the date on which the Secretary is notified that the trust has been changed pursuant to such judicial proceeding or that such proceeding has been terminated."

(9) Subsection (b) of section 2056A is amended by adding at the end the following new paragraphs:

"(10) CERTAIN BENEFITS ALLOWED.—

"(A) IN GENERAL.—If any property remaining in the qualified domestic trust on the date of the death of the surviving spouse is includible in the gross estate of such spouse for purposes of this chapter (or would be includible if such spouse were a citizen or resident of the United States), any benefit which is allowable (or would be allowable if such spouse were a citizen or resident of the United States) with respect to such property to the estate of such spouse under section 2032, 2032A, 2055, 2056, or 6166 shall be allowed for purposes of the tax imposed by paragraph (1)(B).

"(B) SECTION 303.—If the estate of the surviving spouse meets the requirements of section 303 with respect to any property described in subparagraph (A), for purposes of section 303, the tax imposed by paragraph (1)(B) with respect to such property shall be treated as a Federal estate tax payable with respect to the estate of the surviving spouse.

"(C) SECTION 6161(a)(2).—The provisions of section 6161(a)(2) shall apply with respect to the tax imposed by paragraph (1)(B), and the reference in such section to the executor shall be treated as a reference to trustees of the trust.

"(11) SPECIAL RULE WHERE DISTRIBUTION TAX PAID OUT OF TRUST.—For purposes of this subsection, if any portion of the tax imposed by paragraph (1)(A) with respect to any distribution is paid out of the trust, an amount equal to the portion so paid shall be treated as a distribution described in paragraph (1)(A).

"(12) SPECIAL RULE WHERE SPOUSE BECOMES CITIZEN.—If the surviving spouse of the decedent becomes a citizen of the United States and if—

"(A) such spouse was a resident of the United States at all times after the date of the death of the decedent and before such spouse becomes a citizen of the United States,

"(B) no tax was imposed by paragraph (1)(A) with respect to any distribution before such spouse becomes such a citizen, or

"(C) such spouse elects—

"(i) to treat any distribution on which tax was imposed by paragraph (1)(A) as a taxable gift made by such spouse for purposes of—

"(I) section 2001, and

"(II) determining the amount of the tax imposed by section 2501 on actual taxable gifts made by such spouse during the year in which the spouse becomes a citizen or any subsequent year, and

"(ii) to treat any reduction in the tax imposed by paragraph (1)(A) by reason of the credit allowable under section 2010 with respect to the decedent as a credit allowable to such surviving spouse under section 2505 for purposes of determining the amount of the credit allowable under section 2505 with respect to taxable gifts made by the surviving spouse during the year in which the spouse becomes a citizen or any subsequent year.

paragraph (1)(A) shall not apply to any distributions after such spouse becomes such a citizen (and paragraph (1)(B) shall not apply).

"(13) COORDINATION WITH SECTION 1015.—For purposes of section 1015, any distribution on which tax is imposed by paragraph (1)(A) shall be treated as a transfer by gift, and any tax paid under paragraph (1)(A) shall be treated as a gift tax."

(10) Paragraph (2) of section 2056A(c) is amended by striking "The term" and inserting "Except as provided in regulations, the term".

(11) Clause (ii) of section 2056A(b)(2)(B) is amended by striking "as a credit or refund" and inserting "as a credit or refund (with interest)".

(12) Paragraph (2) of section 2056A(b) is amended by adding at the end the following new subparagraph:

"(C) SPECIAL RULE WHERE DECEDENT HAS MORE THAN 1 QUALIFIED DOMESTIC TRUST.—If there is more than 1 qualified domestic trust with respect to any decedent, the amount of the tax imposed by paragraph (1) with respect to such trusts shall be determined by using the highest rate of tax in effect under section 2001 as of the date of the decedent's death (and the provisions of paragraph (3)(B) shall not apply) unless, pursuant to a designation made by the decedent's executor, there is 1 person—

"(i) who is an individual citizen of the United States or a domestic corporation and is responsible for filing all returns of tax imposed under paragraph (1) with respect to such trusts and for paying all tax so imposed, and

"(ii) who meets such requirements as the Secretary may by regulations prescribe."

(13) Section 2056A is amended by adding at the end the following new subsection:

"(e) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations under which there may be treated as a qualified domestic trust any annuity or other payment which is includible in the decedent's gross estate and is by its terms payable for life or a term of years."

(14) In the case of the estate of, or gift by, an individual who was not a citizen or resident of the United States but was a resident of a foreign country with which the United States has a tax treaty with respect to estate, inheritance, or gift taxes, the amendments made by section 5033 of the 1988 Act shall not apply to the extent such amendments would be inconsistent with the provisions of such treaty relating to estate, inheritance, or gift tax marital deductions. In the case of the estate of an individual dying before the date 3 years after the date of the enactment of the Act, or a gift by an individual before the date 3 years after the date of the enactment of this Act, the requirement of the preceding sentence that the individual not be a citizen or resident of the United States shall not apply.

(15) Paragraph (5) of section 2056A(b) (as redesignated by paragraph (7)(B) of this subsection) is amended to read as follows:

"(5) DUE DATE.—

"(A) TAX ON DISTRIBUTIONS.—The estate tax imposed by paragraph (1)(A) shall be due and payable on the 15th day of the 4th month following the calendar year in which the taxable event occurs; except that the estate tax imposed by paragraph (1)(A) on distributions during the calendar year in which the surviving spouse dies shall be due and payable not later than the date on which the estate tax imposed by paragraph (1)(B) is due and payable.

"(B) TAX AT DEATH OF SPOUSE.—The estate tax imposed by paragraph (1)(B) shall be due and payable on the date 9 months after the date of such death."

(16) For purposes of applying section 2040(a) of the Internal Revenue Code of 1986 with respect to any joint interest to which section 2040(b) of such Code does not apply solely by reason of section 2056(d)(1)(B) of the Code, any consideration furnished before July 14, 1988, by the decedent for such interest to the extent treated as a gift to the spouse of the decedent for purposes of chapter 12 of such Code shall be treated as consideration originally belonging to such spouse and never acquired by such spouse from the decedent.

(e) AMENDMENTS RELATED TO SECTION 5041 OF THE 1988 ACT.—

(1) Subparagraph (A) of section 460(e)(6) is amended—

(A) by striking "the building, construction, reconstruction, or rehabilitation of" and inserting "activites referred to in paragraph (4) with respect to", and

(B) by striking clause (i) and inserting the following:

"(i) dwelling units (as defined in section 167(k)) contained in buildings containing 4 or fewer dwelling units (as so defined), and".

(2)(A) Paragraph (4) of section 5041(b) of the 1988 Act is amended by inserting ", as amended by title I of this Act," after "1986 Code".

(B) Paragraph (3) of section 56(a) is amended by striking "The preceding sentence shall not" and inserting "The first sentence of this paragraph shall not".

(3) Subparagraph (C) of section 5041(e)(1) of the 1988 Act is amended by striking "subsections (a), (b) and (c)" and inserting "subsections (a) and (b)".

(4) Clause (i) of section 56(g)(4)(D) is amended by adding "and" at the end of subclause (III) and by striking subclauses (IV) and (V) and inserting the following new subclause:

"(IV) paragraphs (6), (7), and (8) shall not apply."

(f) AMENDMENT RELATED TO SECTION 5053 OF THE 1988 ACT.—Subsection (d) of section 145 is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) CERTAIN PROPERTY TREATED AS NEW PROPERTY.—Solely for purposes of determining under paragraph (2)(A) whether the 1st use of property is pursuant to tax-exempt financing—

"(A) IN GENERAL.—If—

"(i) the 1st use of property is pursuant to taxable financing,

"(ii) there was a reasonable expectation (at the time such taxable financing was provided) that such financing would be replaced by tax-exempt financing, and

"(iii) the taxable financing is in fact so replaced within a reasonable period after the taxable financing was provided,

then the 1st use of such property shall be treated as being pursuant to the tax-exempt financing.

"(B) SPECIAL RULE WHERE NO OPERATING STATE OR LOCAL PROGRAM FOR TAX-EXEMPT FINANCING.—If, at the time of the 1st use of property, there was no operating State or local program for tax-exempt financing of the property, the 1st use of the property shall be treated as pursuant to the 1st tax-exempt financing of the property.

"(C) DEFINITIONS.—For purposes of this paragraph—

"(i) TAX-EXEMPT FINANCING.—The term 'tax-exempt financing' means financing provided by tax-exempt bonds.

"(ii) TAXABLE FINANCING.—The term 'taxable financing' means financing which is not tax-exempt financing."

(g) AMENDMENT RELATED TO SECTION 5076 OF THE 1988 ACT.—Paragraph (3) of section 453A(b) is amended to read as follows:

"(3) EXCEPTION FOR PERSONAL USE AND FARM PROPERTY.—An installment obligation shall not be

treated as described in paragraph (1) if it arises from the disposition—

"(A) by an individual of personal use property (within the meaning of section 1275(b)(3)), or

"(B) of any property used or produced in the trade or business of farming (within the meaning of section 2032A(e)(4) or (5))."

(h) AMENDMENT RELATED TO SECTION 5077 OF THE 1988 ACT.—Clause (ii) of section 382(l)(3)(C) is amended by striking "for purposes of subclause (III)," and inserting "For purposes of subclause (III),".

SEC. 7816. AMENDMENTS RELATED TO TITLE VI OF THE 1988 ACT.

(a) AMENDMENT RELATED TO SECTION 6003 OF THE 1988 ACT.—Paragraph (2) of section 274(n) is amended—

(1) by striking so much of such paragraph as follows subparagraph (D) and precedes subparagraph (F) and inserting the following:

"(E) in the case of an employer who pays or reimburses moving expenses of an employee, such expenses are includible in the income of the employee under section 82, or", and

(2) by adding at the end the following new sentence: "In the case of the employee, the exception of subparagraph (A) shall not apply to expenses described in subparagraph (E)."

(b) AMENDMENT RELATED TO SECTION 6006 OF THE 1988 ACT.—Subparagraph (A) of section 1(i)(7) is amended by inserting "(other than for purposes of this paragraph)" after "shall be treated".

(c) AMENDMENTS RELATED TO SECTION 6009 OF THE 1988 ACT.—

(1) Paragraph (2) of section 6009(c) of the 1988 Act is amended by striking "Clause (i)" and inserting "Clause (ii)".

(2) Paragraph (1) of section 135(d) is amended by striking "subsection (a) respect to" and inserting "subsection (a) with respect to".

(d) AMENDMENTS RELATED TO SECTION 6026 OF THE 1988 ACT.—

(1) Subparagraph (D) of section 263A(h)(3) is amended to read as follows:

"(D) TREATMENT OF CERTAIN CORPORATIONS.—

"(i) IN GENERAL.—If—

"(I) substantially all of the stock of a corporation is owned by a qualified employee-owner and members of his family (as defined in section 267(c)(4)), and

"(II) the principal activity of such corporation is performance of personal services directly related to the activities of the qualified employee-owner and such services are substantially performed by the qualified employee-owner,

this subsection shall apply to any expense of such corporation which directly relates to the activities of such employee-owner in the same manner as if such expense were incurred by such employee-owner.

"(ii) QUALIFIED EMPLOYEE-OWNER.—For purposes of this subparagraph, the term 'qualified employee-owner' means any individual who is an employee-owner of the corporation (as defined in section 269A(b)(2)) and who is a writer, photographer, or artist."

(2) Subparagraph (B) of section 6026(d)(2) of the 1988 Act is amended by striking "the taxpayer made" and inserting "a taxpayer engaged in a farming business involving the production of animals having a preproductive period of more than 2 years made".

(e) AMENDMENTS RELATED TO SECTION 6028 OF THE 1988 ACT.—

(1) Paragraph (5) of section 168(b) is amended by striking "paragraph (2)(B)" and inserting "paragraph (2)(C)".

(2) Paragraph (2) of section 168(c) is amended by striking "subsection (b)(2)(B)" and inserting "subsection (b)(2)(C)".

(f) AMENDMENT RELATED TO SECTION 6029 OF THE 1988 ACT.—The subparagraph (D) of section 168(b)(3) added by section 6029 of the 1988 Act is redesignated as subparagraph (E).

(g) AMENDMENT RELATED TO SECTION 6033 OF THE 1988 ACT.—Subsection (b) of section 6033 of the 1988 Act is amended by striking "paragraph (1)" and inserting "subsection (a)".

(h) AMENDMENT RELATED TO SECTION 6054 OF THE 1988 ACT.—Paragraph (1) of section 6054(b) of the 1988 Act is amended by striking "subsection apply" and inserting "section shall apply".

(i) AMENDMENT RELATED TO SECTION 6061 OF THE 1988 ACT.—Section 6061 of the 1988 Act is amended—

(1) by striking "section 111B(h)(5)(A)" and inserting "section 1011B(h)(5)(A)", and

(2) by striking section 111B(h)" and inserting "section 1011B(h)".

(j) AMENDMENT RELATED TO SECTION 6064 OF THE 1988 ACT.—Paragraph (13) of section 457(e) is amended to read as follows:

"(13) SPECIAL RULE FOR CHURCHES.—The term 'eligible employer' shall not include a church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B))."

(k) AMENDMENT RELATED TO SECTION 6067 OF THE 1988 ACT.—Subsection (c) of section 6067 of the 1988 Act is amended by striking "section 205(c)" and inserting "section 2005(c)".

(l) AMENDMENT RELATED TO SECTION 6071 OF THE 1988 ACT.—Paragraph (2) of section 6071(b) of the 1988 Act is amended by striking "electric plan" and inserting "electric cooperative plan".

(m) PROVISION RELATED TO SECTION 6076 OF THE 1988 ACT.—If, for the 1st taxable year beginning on or after January 1, 1987, a qualified group self-insurers' fund changes its treatment of policyholder dividends to take into account such dividends no earlier than the date that the State regulatory authority determines the amount of the policyholder dividend that may be paid, then such change shall be treated as a change in a method of accounting and no adjustment under section 481(a) of the Internal Revenue Code of 1986 shall be made with respect to such change in method of accounting.

(n) AMENDMENTS RELATED TO SECTION 6077 OF THE 1988 ACT.—

(1) Paragraph (1) of section 847 is amended—

(A) by striking "separate estimated tax" and inserting "special estimated tax", and

(B) by striking "after December 31, 1986" and inserting "in taxable years beginning after December 31, 1986".

(2) The first sentence of section 847(2) is amended to read as follows: "The deduction under paragraph (1) shall be allowed only to the extent that such deduction would result in a tax benefit for the taxable year for which such deduction is allowed or any carryback year and only to the extent that special estimated tax payments are made in an amount equal to the tax benefit attributable to such deduction on or before the due date (determined without regard to extensions) for filing the return for the taxable year for which the deduction is allowed."

(3) Paragraph (5) of section 847 is amended by adding at the end the following new sentence: "To the extent that any amount added to the special loss discount account is not subtracted from such account before the 15th year after the year for which the amount was so added, such amount shall be subtracted from such account for such 15th year and included in gross income for such 15th year."

(4) Paragraph (9) of section 847 is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by adding at the end the following new subparagraph:

"(C) providing for the application of this section in cases where the deduction allowed under paragraph (1) for any taxable year is less than the excess referred to in paragraph (1) for such year."

(5) Section 847 (as amended by paragraph (4)) is amended by redesignating paragraph (9) as paragraph (10) and by inserting after paragraph (8) the following new paragraph:

"(9) EFFECT ON EARNINGS AND PROFITS.—In determining the earnings and profits—

"(A) any special estimated tax payment made for any taxable year shall be treated as a payment of income tax imposed by this title for such taxable year, and

"(B) any deduction or inclusion under this section shall not be taken into account.

Nothing in the preceding sentence shall be construed to affect the application of section 56(g) (relating to adjustments based on adjusted current earnings)."

(6) Paragraph (8) of section 847 is amended by adding at the end the following new sentence: "The limitations on consolidation contained in section 1503(c) shall not apply to the deduction allowed under paragraph (1)."

(o) AMENDMENTS RELATED TO SECTION 6105 OF THE 1988 ACT.—

(1) The subsection (c) of section 5276 added by section 6105 of the 1988 Act is amended—

(A) by striking "(c) EXEMPTION" and inserting "(d) EXCEPTION",

(B) by striking "section 5271(a)(2)" in paragraph (1) and inserting "section 5271", and

(C) by striking "specially denatured distilled spirits" in paragraph (2) and inserting "distilled spirits free of tax".

(2) Subsection (a) of section 5276 is amended by striking "Except as provided in subsection (c)," and inserting "Except as otherwise provided in this section,".

(p) AMENDMENT RELATED TO SECTION 6135 OF THE 1988 ACT.—Paragraph (3) of section 953(d) is amended by striking "(as defined in section 1503(d))" and inserting "for purposes of section 1503(d) without regard to paragraph (2)(B) thereof".

(q) AMENDMENT RELATED TO SECTION 6152 OF THE 1988 ACT.—Subparagraph (C) of section 2056(b)(7) is amended by striking "an annuity" and inserting "an annuity included in the gross estate of the decedent under section 2039".

(r) AMENDMENT RELATED TO SECTION 6177 OF THE 1988 ACT.—Sub clause (III) of section 148(f)(4)(B)(iii) is amended by striking "such date of issuance. or the date" and inserting "such date of issuance or the date".

(s) AMENDMENTS RELATED TO SECTION 6180 OF THE 1988 ACT.—

(1) Paragraph (1) of section 142(i) is amended by inserting "IN GENERAL.—" after "(1)".

(2) The paragraph (3) of section 146(g) added by section 6180 of the 1988 Act is redesignated as paragraph (4).

(3) Paragraph (3) of section 147(c) is amended by inserting a comma after "mass commuting facility" each place it appears.

(t) AMENDMENTS RELATED TO SECTION 6183 OF THE 1988 ACT.—Subclause (II) of section 148(f)(4)(C)(ii) is amended by striking "on behalf of" and inserting "to make loans to".

(u) AMENDMENTS RELATED TO SECTION 6228 OF THE 1988 ACT.—

(1) The section 7520 added by section 6228 of the 1988 Act is redesignated as section 7521.

(2) The table of sections for chapter 77 is amended by striking the item added by section 6228 of the 1988 Act and inserting the following:

"Sec. 7521. Procedures involving taxpayer interviews."

(v) AMENDMENTS RELATED TO SECTION 6242 OF THE 1988 ACT.—

(1) The section 6712 added by section 6242 of the 1988 Act is redesignated as section 6713.

(2) The table of sections for part I of subchapter B of chapter 68 is amended by striking the item added by section 6242 of the 1988 Act and inserting the following:

"Sec. 6713. Disclosure or use of information by preparers of returns."

(w) AMENDMENT RELATED TO SECTION 6253 OF THE 1988 ACT.—Section 6253 of the 1988 Act is amended by inserting ", as amended by title I of this Act," after "1986 Code".

SEC. 7817. EFFECTIVE DATE.

Except as otherwise provided in this part, any amendment made by this part shall take effect as if included in the provision of the 1988 Act to which such amendment relates.

PART II—AMENDMENTS RELATED TO REVENUE ACT OF 1987

SEC. 7821. AMENDMENTS RELATED TO SUBTITLE B.

(a) AMENDMENTS RELATED TO SECTION 10202 OF THE 1987 ACT.—

(1) Subparagraph (B) of section 453A(b)(2) is amended by striking

"all obligations of the taxpayer described in paragraph (1)" and inserting "all such obligations held by the taxpayer".

(2) Subparagraph (B) of section 453A(d)(2) is amended by striking "before such secured indebtedness was incurred" and inserting "before the later of the times referred to in subparagraph (A) or (B) of paragraph (1)".

(3) Subparagraph (B) of section 453A(d)(1) is amended by inserting "the time" before the "the proceeds".

(4)(A) Paragraph (2) of section 26(b) (as amended by section 11811) is amended by striking "and" at the end of subparagraph (L), by striking the period at the end of subparagraph (M) and inserting ", and", and by adding at the end the following new subparagraph:

"(N) sections 453(l)(3) and 453A(c) (relating to interest on certain deferred tax liabilities)."

(B) Subsection (c) of section 453A is amended by redesignating paragraph (5) as paragraph (6) and by inserting after paragraph (4) the folowing new paragraph:

"(5) TREATMENT AS INTEREST.—Any amount payable under this subsection shall be taken into account in computing the amount of any deduction allowable to the taxpayer for interest paid or accrued during the taxable year."

(5) In the case of taxable years beginning in 1987, the reference to section 453 contained in section 56(a)(6) of the Internal Revenue Code of 1986 shall be treated as including a reference to section 453A.

(b) AMENDMENTS RELATED TO SECTION 10206 OF THE 1987 ACT.—Effective with respect to taxable years beginning after 1988, the last sentence of section 7519(d)(4) is amended—

(1) by striking "for taxable years beginning after 1987,",

(2) by striking "if more than 50 percent" and inserting "unless more than 50 percent", and

(3) by striking "who would not have been entitled" and inserting "who would have been entitled".

(c) AMENDMENT RELATED TO SECTION 10222 OF THE 1987 ACT.—Clause (ii) of section 1503(e)(2)(A) is amended by striking "another member" and inserting "another corporation which is or was a member".

(d) AMENDMENTS RELATED TO SECTION 10242 OF THE 1987 ACT.—

(1) The item relating to section 842 in the table of sections for part III of subchapter L of chapter 1 is amended by striking "corporations" and inserting "companies".

(2) The heading for paragraph (4) of section 842(c) is amended by striking "YEILDS" and inserting "YIELDS".

SEC. 7822. AMENDMENTS RELATED TO SUBTITLE C AND FOLLOWING SUBTITLES.

(a) AMENDMENT RELATED TO SECTION 10301 OF THE 1987 ACT.—Paragraph (1) of section 6655(e) is amended by striking "section (d)(1)" and inserting "subsection (d)(1)".

(b) AMENDMENTS RELATED TO SECTION 10502 OF THE 1987 ACT.—

(1) Paragraph (1) of section 6427(i) is amended by striking "subsection (a)" and all that follows through "by any person" and inserting "subsection (a), (b), (c), (d), (e), (g), (h), (l), or (q) by any person".

(2) Clause (i) of section 6427(i)(2)(A) is amended to read as follows:

"(I) $1,000 or more is payable under subsections (a), (b), (d), (e), (g), (h), and (q), or".

(3) Subparagraph (B) of section 6427(i)(2) is amended to read as follows:

"(B) SPECIAL RULE.—If the requirements of subparagraph (A)(ii) are met by any person for any quarter but the requirements of subparagraph (A)(i) are not met by such person for such quarter, such person may file a claim under subparagraph (A) for such quarter only with respect to amounts referred to in subparagraph (A)(ii)."

(4) The subsection of section 6427 relating to payments for taxes imposed by section 4041(d) is redesignated as subsection (p).

(5) Paragraph (3) of section 9502(b) is amended by striking ", and" and inserting "; and".

(6) Subparagraph (A) of section 9503(b)(4) is amended by striking "sections 4041(d)" and inserting "section 4041(d)".

(7) Subsections (b)(3) and (c)(2)(A) of section 9508 are each amended by striking "Storage Trust Fund" and inserting "Storage Tank Trust Fund".

(c) AMENDMENT RELATED TO SECTION 10611 OF THE 1987 ACT.—The table of sections for part II of subchapter B of chapter 1 is amended by inserting "Illegal" before "Federal" in the item relating to section 90.

(d) AMENDMENTS RELATED TO SECTION 10713 OF THE 1987 ACT.—

(1) Subparagraph (G) of section 10713(b)(2) of the 1987 Act is amended to read as follows:

"(G) Paragraph (3) of section 7611(i) is amended by striking all that follows 'income tax)' and inserting', section 6852 (relating to termination assessments in the case of flagrant political expenditures of section 501(c)(3) organizations), or section 6861 (relating to jeopardy assessments of income taxes, etc.),'."

(2) Clause (iii) of section 10713(b)(2)(E) of the 1987 Act is amended to read as follows:

"(iii) by striking '6851(a) nor 6861(a)' in subsection (b)(3)(A)(iii) and inserting '6851(a), 6852(a), nor 6861(a)'."

SEC. 7823. EFFECTIVE DATE.

Except as otherwise provided in this part, any amendment made by this part shall take effect as if included in the provision of the 1987 Act to which such amendment relates.

PART III—AMENDMENTS RELATED TO TAX REFORM ACT OF 1986

SEC. 7831. AMENDMENTS RELATED TO TAX REFORM ACT OF 1986.

(a) AMENDMENT RELATED TO SECTION 101 OF THE 1986 ACT.—Subparagraph (B) of section 1(f)(6) (relating to rounding of inflation adjustments for married individuals filing separately) is amended by striking "(other than with respect to section 63(c)(4))" and inserting the following: "(other than with respect to subsection (c)(4) of section 63 (as it applies to subsections (c)(5)(A) and (f) of such section) and section 151(d)(3))".

(b) AMENDMENT RELATED TO SECTION 201 OF THE 1986 ACT.—Paragraph (5) of section 1250(b) is amended—

(1) by striking "in the case of recovery property" in subparagraph (A) and inserting "in the case of property to which section 168 applies", and

(2) by striking "in the case of any property which is not recovery property" in subparagraph (B) and inserting "in the case any property to which section 168 does not apply".

(c) AMENDMENTS RELATED TO SECTION 252 OF THE 1986 ACT.—

(1) Subparagraph (B) of section 42(i)(3) (defining low-income unit) is amended by inserting "(as determined under regulations prescribed by the Secretary taking into account local health, safety, and building codes)" after "suitable for occupancy".

(2) Paragraph (3) of section 42(i) is amended by adding at the end the following new subparagraph:

"(D) STUDENTS IN GOVERNMENT-SUPPORTED JOB TRAINING PROGRAMS NOT TO DISQUALITY UNIT.—A unit shall not fail to be treated as a low-income unit merely because it is occupied by an individual who is enrolled in a job training program receiving assistance under the Job Training Partnership Act or under other similar Federal, State, or local laws."

(3) Subsection (i) of section 42 (relating to special rules) is amended by adding at the end the following new paragraph:

"(6) APPLICATION TO ESTATES AND TRUSTS.—In the case of an estate or trust, the amount of the credit determined under subsection (a) and any increase in tax under subsection (j) shall be apportioned between the estate or trust and the beneficiaries on the basis of the income of the estate or trust allocable to each."

(4) Subsection (f) of section 42 is amended by adding at the end the following new paragraph:

"(4) DISPOSITIONS OF PROPERTY.—If a building (or an interest therein) is disposed of during any year for which credit is allowable under subsection (a), such credit shall be allocated between the parties on the basis of the number of days during such year the building (or interest) was held by each. In any such case, proper adjustments shall be made in the application of subsection (j)."

(5) Subsection (m) of section 42 (relating to regulations) is amended by striking "and" at the end of paragraph (2), by striking the period at the end of paragraph (3) and inserting ", and", and by adding at the end the following new paragraph:

"(4) providing the opportunity for housing credit agencies to correct administrative errors and omissions with respect to allocations and record keeping within a reasonable period after their discovery, taking into account the availability of regulations and other administrative guidance from the Secretary."

(6) Subparagraph (A) of section 42(d)(7) is amended by inserting "(or interest therein)" after "a building described in subparagraph (B)".

(d) AMENDMENTS RELATED TO SECTION 803 OF THE 1986 ACT.—

(1) Subparagraph (A) of section 803(d)(4) of the Tax Reform Act of 1986 is amended by striking so much of such subparagraph as precedes clause (i) thereof and inserting the following:

"(A) TRANSITION PROPERTY EXEMPTED FROM INTEREST CAPITALIZATION.—Section 263A of the Internal Revenue Code of 1986 (as added by this section) and the amendment made by subsection (b)(1) shall not apply to interest costs which are allocable to any property—".

(2) If any interest costs incurred after December 31, 1986, are attributable to costs incurred before January 1, 1987, the amendments made by section 803 of the Tax Reform Act of 1986 shall apply to such interest costs only to the extent such interest costs are attributable to costs which were required to be capitalized under section 263 of the Internal Revenue Code of 1954 and which would have been taken into account in applying section 189 of the Internal Revenue Code of 1954 (as in effect before its repeal by section 803 of the Tax Reform Act of 1986) or, if applicable, section 266 of such Code.

(e) APPLICATION OF FUTURE LEGISLATION TO TRANSITIONED BONDS.—Section 1318 of the Tax Reform Act of 1986 is amended by adding at the end the following new paragraph:

"(8) APPLICATION OF FUTURE LEGISLATION TO TRANSITIONED BONDS.—In the case of any bond to which the amendments made by section 1301 do not apply by reason of a provision of this Act, any amendment of the 1986 Code (and any other provision applicable to such Code) included in any law enacted after October 22, 1986, shall be treated as included in section 103 and section 103A (as appropriate) of the 1954 Code with respect to such bond unless—

"(A) such law expressly provides that such amendment (or other provision) shall not apply to such bond, or

"(B) such amendment (or other provision) applies to a provision of the 1986 Code—

"(i) for which there is no corresponding provision in section 103 and section 103A (as appropriate) of the 1954 Code, and

"(ii) which is not otherwise treated as included in such sections 103 and 103A with respect to such bond."

(f) AMENDMENT RELATED TO SECTION 1114 OF THE 1986 ACT.—Subparagraphs (A) and (B) of section 1114(b)(9) of the Tax Reform Act of 1986 are each amended by striking "consist of supervising" and inserting "consist in supervising".

(g) EFFECTIVE DATE.—Any amendment made by this section shall take effect as if included in the provision of the Tax Reform Act of 1986 to which such amendment relates.

PART IV—MISCELLANEOUS CHANGES

SEC. 7841. MISCELLANEOUS CHANGES.

(a) AMENDMENT RELATED TO TRANSFERS INCIDENT TO DIVORCE OR SEPARATION.—

(1) Paragraph (6) of section 408(d) is amended by striking "his former spouse under a divorce decree or under a written instrument incident to such divorce" and in-

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serting "his spouse or former spouse under a divorce or separation instrument described in subparagraph (A) of section 71(b)(2)".

(2) Subsection (p) of section 414 is amended by redesignating paragraph (11) as paragraph (12) and by inserting after paragraph (10) the following new paragraph:

"(11) APPLICATION OF RULES TO GOVERNMENTAL AND CHURCH PLANS.—For purposes of this title, a distribution or payment from a governmental plan (as defined in subsection (d)) or a church plan (as described in subsection (e)) shall be treated as made pursuant to a qualified domestic relations order if it is made pursuant to a domestic relations order which meets the requirement of clause (i) of paragraph (1)(A)."

(3) The amendments made by this subsection shall apply to transfers after the date of the enactment of this Act in taxable years ending after such date.

(b) AMENDMENT RELATED TO SINGLE-EMPLOYER PENSION PLAN AMENDMENTS ACT OF 1986.—

(1) Section 404(g)(1) is amended by inserting "4041(b)," before "4062".

(2) The amendment made by paragraph (1) shall apply to payments made after January 1, 1986, in taxable years ending after such date.

(c) DEFINITION OF COMPENSATION.—

(1) Paragraph (1) of section 219(f) (defining compensation) is amended by adding at the end thereof the following new sentence: "For purposes of this paragraph, section 401(c)(2) shall be applied as if the term trade or business for purposes of section 1402 included service described in subsection (c)(6).

(2) The amendment made by paragraph (1) shall apply to contributions after the date of the enactment of this Act in taxable years ending after such date.

(d) MISCELLANEOUS CLERICAL CHANGES.—

(1) Paragraph (1) of section 6103(d) is amended by striking "45,".

(2) Section 6871 is amended by striking "44, or 45" each place it appears and inserting "or 44".

(3) Paragraph (5) of section 691(c) is amended by striking "paragraph (1)(D)" and inserting "paragraph (1)(C)".

(4) The table of chapters for subtitle D is amended by striking the comma in the item relating to chapter 42 and inserting a semicolon.

(5) Section 6652 is amended—

(A) by redesignating the subsection relating to information with respect to includible employee benefits as subsection (k), and

(B) by redesignating the subsection relating to alcohol and tobacco taxes as subsection (l).

(6) Paragraph (2) of section 410(a) is amended by striking the comma before the period.

(7) The heading of paragraph (1) of section 132(h) is amended by striking "OFFICERS, ETC.," and inserting "HIGHLY COMPENSATED EMPLOYEES".

(8) Paragraph (1) of section 66(d) is amended by striking "section 911(b)" and inserting "section 911(d)(2)".

(9) Subsection (e) of section 861 is amended by striking "section 826(a)" and inserting "section 862(a)".

(10) Paragraph (27) of section 381(a) (relating to credit under section 53) is redesignated as paragraph (26).

(11) Subclause (III) of section 382(l)(3)(B)(i) is amended by striking "divorce," and inserting "divorce),".

(12) The last sentence of section 6157(a) is amended by striking "subsections (c) and (d)" and inserting "subsection (c)".

(13) Clause (i) of section 42(d)(6)(A) is amended by striking "Farmers' Home Administration" and inserting "Farmers Home Administration".

(14) Clause (ii) of section 42(d)(7)(A) is amended by striking "sebsection (a)" and inserting "subsection (a)".

(15) Subparagraph (A) of section 42(e)(2) is amended by striking "captial account" and inserting "capital account".

(16) Paragraph (2) of section 844(a) is amended by striking "for the taxable year" and inserting "for a prior taxable year".

(17) Subsection (c) of section 4221 is amended by striking "or 4083".

(18) Clause (i) of section 274(n)(2)(F) is amended by inserting "any" before "Federal".

(19) Subparagraph (B) of section 132(f)(2) is amended by striking "section 151(e)(3)" and inserting "section 151(c)(3)".

(20) Sections 6420(e)(2), 6421(g)(2), and 6427(j)(2) are each amended by striking "section 7602" and inserting "section 7602(a)".

(e) AMENDMENT RELATED TO TREATMENT OF TRANSACTIONS IN WHICH FEDERAL FINANCIAL ASSISTANCE PROVIDED.—

(1) Section 597(b)(2) is amended by striking "to reflect such treatment" and inserting "in connection with such assistance".

(2) The amendment made by this subsection shall apply as if included in the amendments made by section 1401 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

(f) AMENDMENT RELATED TO ALCOHOL, TOBACCO, AND FIREARMS RETURNS.—Paragraph (6) of section 6091(b) is amended by inserting "section 4181 or" before "subtitle E".

(g) AUTHORITY TO PAY ADMINISTRATIVE EXPENSES FROM VACCINE INJURY COMPENSATION TRUST FUND.

(1) IN GENERAL.—Paragraph (1) of section 9510(c) (relating to expenditures from Vaccine Injury Compensation Trust Fund) is amended by inserting before the period at the end thereof the following: ", or for the payment of all expenses of administration (but not in excess of $6,000,000 for any fiscal year) incurred by the Federal Government in administering such subtitle".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to fiscal years beginning after September 30, 1989.

PART V—AMENDMENTS RELATED TO PENSION PROVISIONS

SEC. 7851. DEFINITIONS

For purposes of this part—

(1) REFORM ACT.—Except where incompatible with the intent, the term "Reform Act" means the Tax Reform Act of 1986.

(2) ERISA.—The term "ERISA" means the Employee Retirement Income Security Act of 1974.

Subpart A.—Amendments Related To Tax Reform Act of 1986

SEC. 7861. AMENDMENTS RELATED TO TITLE XI OF THE REFORM ACT.

(a) AMENDMENTS RELATED TO SECTION 1113 OF THE REFORM ACT.—

(1) Section 203(a)(2) of ERISA is amended—

(A) by striking "following" the first place it appears, and

(B) by striking "414(f)(1)(B)" in subparagraph (C)(ii)(I) and inserting "3(37)(A)(ii)".

(2) Section 1113(e)(3) of the Reform Act is amended by striking "Section 202(B)(i)" and inserting "Section 202(a)(1)(B)(i)".

(3) The second subsection (e) of section 1113 of the Reform Act is redesignated as subsection (f).

(4) Section 1113(f) of the Reform Act, as redesignated by paragraph (3), is amended by adding at the end thereof the following new paragraph:

"(4) REPEAL OF CLASS YEAR VESTING.—If a plan amendment repealing class year vesting is adopted after October 22, 1986, such amendment shall not apply to any employee for the 1st plan year to which the amendments made by subsections (b) and (e)(2) apply (and any subsequent plan year) if—

"(A) such plan amendment would reduce the nonforfeitable right of such employee for such year, and

"(B) such employee has at least 1 hour of service before the adoption of such plan amendment and after the beginning of such 1st plan year.

This paragraph shall not apply to an employee who has 5 consecutive 1-year breaks in service (as defined in section 411(a)(6)(A) of the Internal Revenue Code of 1986) which include the 1st day of the 1st plan year to which the amendments made by subsection (b) and (e)(2) apply. A plan shall not be treated as failing to meet the requirements of section 401(a)(26) of such Code by reason of complying with the provisions of this paragraph."

(5)(A) Section 411(a)(3) is amended by adding at the end thereof the following new subparagraph:

"(G) TREATMENT OF MATCHING CONTRIBUTIONS FORFEITED BY REASON OF EXCESS DEFERRAL OR CONTRIBUTION.—A matching contribution (within the meaning of section 401(m)) shall not be treated as forfeitable merely because such contribution is forfeitable if the contribution to which the matching contribution relates is treated as an excess contribution under section 401(k)(8)(B), an excess deferral under section 402(g)(2)(A), or an excess aggregate contribution under section 401(m)(6)(B).".

(B) Paragraph (3) of section 203(a) of ERISA is amended by adding at the end thereof the following new subparagraph:

"(F) A matching contribution (within the meaning of section 401(m) of the Internal Revenue Code of 1986) shall not be treated as forfeitable merely because such contribution is forfeitable if the contribution to which the matching contribution relates is treated as an excess contribution under section 401(K)(8)(B) of such Code, an excess deferral under section 402(g)(2)(A) of such Code, or an excess aggregate contribution under section 401(m)(6)(B) of such Code.".

(6)(A) Section 411(a)(4)(A) is amended to read as follows:

"(A) years of service before age 18,".

(B) Subparagraph (A) of section 203(b)(1) of ERISA is amended to read as follows:

"(A) years of service before age 18,".

(b) AMENDMENT RELATED TO SECTION 1132 OF THE ACT.—

(1) Notwithstanding any other provision of law, in the case of any qualified pension plan and welfare benefit plan described in paragraph (2), the assets of such pension plan in excess of its liabilities may be transferred to such welfare benefit plan upon the termination of such pension plan if such assets are to be used to provide retiree health benefits.

(2) For purposes of paragraph (1), a qualified pension plan and welfare benefit plan are described in this paragraph if—

(A) both such plans are jointly administered pursuant to a collective bargaining agreement between the employer maintaining such plans and one or more employee representatives,

(B) the welfare benefit plan provides retiree health benefits, and

(C) the qualified pension plan has assets in excess of liabilities (determined on a termination basis) and the welfare benefit plan has assets which are less than the present value of the benefits to be provided under the plan (determined as of the time of termination of the pension plan).

(3) For purposes of the Internal Revenue Code of 1986, any transfer of assets to which paragraph (1) applies shall be treated as a reversion of such assets to the employer maintaining the plan which is includible in the gross income of such employer and subject to the tax imposed by section 4980 of such Code.

(c) AMENDMENTS RELATED TO SECTION 1140 OF THE REFORM ACT.—

(1) Subsection (a) of section 1140 of the Reform Act is amended by striking "or subtitle C" and inserting ", subtitle C, or title XVIII of this Act".

(2) Section 1140(c) of the Reform Act is amended by striking all after "the first plan year beginning" and inserting "after the later of—

"(1) December 31, 1988, or

"(2) the earlier of—

"(A) December 31, 1990, or

"(B) the date on which the last of such collective bargaining agreements terminate (without regard to any extension after February 28, 1986)."

(3) Section 1140(c) is amended by adding at the end thereof the following new flush sentence:

"For purposes of paragraph (1)(B) and any other provision of this title, an agreement shall not be treated as terminated merely because the plan is amended pursuant to such agreement to meet the requirements of any

amendment made by this title or title XVIII of this Act.".

(d) AMENDMENTS RELATED TO SECTION 1145 OF THE REFORM ACT.—

(1) Subsection (f) of section 303 of the Retirement Equity Act of 1984 is amended by striking "July 24, 1984" and inserting "July 17, 1984".

(2) Paragraph (3) of section 205(b) of ERISA, as added by section 1145(b) of the Reform Act, is redesignated as paragraph (4).

SEC. 7862. AMENDMENTS RELATED TO TITLE XVIII OF THE REFORM ACT.

(a) AMENDMENT RELATED TO SECTION 1852 OF THE REFORM ACT.—Paragraph (1) of section 4402(h) of ERISA is amended by striking "January 12, 1982" the second place it appears and inserting "January 16, 1982".

(b) AMENDMENT RELATED TO SECTION 1879 OF THE REFORM ACT.—

(1) Subsection (u) of section 1879 of the Reform Act is amended—

(A) by striking "206(h)" each place it appears in paragraphs (1) and (4)(B) and inserting "204(h)",

(B) by redesignating paragraph (4) as paragraph (5), and

(C) by inserting after paragraph (3) the following:

"(4) CORRECTION OF CROSS REFERENCE.—Section 4218(1)(A) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1398(1)(A)) is amended by striking 'section 4062(d)' and inserting 'section 4069(b)'."

(2) So much of section 204(h)(2) of ERISA as precedes subparagraph (A) thereof is amended by adjusting the left-hand margination thereof to full measure.

(c) AMENDMENTS RELATED TO SECTION 1895 OF THE REFORM ACT.—

(1)(A) Section 106(b)(2) (relating to exception to certain plans) is amended by striking the last sentence thereof.

(B) Section 601(b) of ERISA is amended by striking the last sentence thereof.

(C) The amendments made by this paragraph shall apply to years beginning after December 31, 1986.

(2)(A) Section 607(2) of ERISA is amended by striking "the individual's employment or previous employment with an employer" and inserting "the performance of services by the individual for 1 or more persons maintaining the plan (including as an employee defined in section 401(c)(1) of the Internal Revenue Code of 1986)"

(B) Section 4980B(f)(7), as added by the Technical and Miscellaneous Revenue Act of 1988, is amended by striking "the individual's employment or previous employment with an employer" and inserting "the performance of services by the individual for 1 or more persons maintaining the plan (including as an employee defined in section 401(c)(1))".

(C) The amendments made by this paragraph shall apply to plan years beginning after December 31, 1989.

(3)(A) Clause (iv) of section 162(k)(2)(B) is amended—

(i) by striking "ELIGIBILITY" in the heading and inserting "ENTITLEMENT", and

(ii) by inserting "which does not contain any exclusion or limitation with respect to any preexisting condition of such beneficiary" after "or otherwise)" in subclause (I).

(B) Section 602(2)(D) of ERISA is amended—

(i) by striking "ELIGIBILITY" in the heading and inserting "ENTITLEMENT", and

(ii) by inserting "which does not contain any exclusion or limitation with respect to any preexisting condition of such beneficiary" after "or otherwise)" in clause (i).

(C) Clause (iv) of section 4980B(f)(2)(B), as added by the Technical and Miscellaneous Revenue Act of 1988, is amended—

(i) by striking "ELIGIBILITY" in the heading and inserting "ENTITLEMENT", and

(ii) by inserting "which does not contain any exclusion or limitation with respect to any preexisting condition of such beneficiary" after "or otherwise)" in subclause (I).

(D) The amendments made by this paragraph shall apply to—

(i) qualifying events occurring after December 31, 1989, and

(ii) in the case of qualified beneficiaries who elected continuation coverage after December 31, 1988, the period for which the required premium was paid (or was attempted to be paid but was rejected as such).

(4)(A) The last sentence of section 602(3) of ERISA is amended to read as follows:

"In no event may the plan require the payment of any premium before the day which is 45 days after the day on which the qualified beneficiary made the initial election for continuation coverage."

(B) The last sentence of section 4980B(f)(2)(C) of the 1986 Code (as added by the Technical and Miscellaneous Revenue Act of 1988) is amended to read as follows:

"In no event may the plan require the payment of any premium before the day which is 45 days after the day on which the qualified beneficiary made the initial election for continuation coverage."

(C) The amendments made by this paragraph shall apply to plan years beginning after December 31, 1989.

(5)(A) Clause (i) of section 4980(f)(2)(B) is amended by adding at the end thereof the following new subclause:

"(V) QUALIFYING EVENT INVOLVING MEDICARE ENTITLEMENT.—In the case of an event described in paragraph (3)(D) (without regard to whether such event is a qualifying event), the period of coverage for qualified beneficiaries other than the covered employee for such event or any subsequent qualifying event shall not terminate before the close of the 36-month period beginning on the date the covered employee becomes entitled to benefits under title XVIII of the Social Security Act."

(B) Section 602(2)(A) of ERISA is amended by adding at the end thereof the following new clause:

"(v) QUALIFYING EVENT INVOLVING MEDICARE ENTITLEMENT.—In the case of an event described in section 603(4) (without regard to whether

such event is a qualifying event), the period of coverage for qualified beneficiaries other than the covered employee for such event or any subsequent qualifying event shall not terminate before the close of the 36-month period beginning on the date the covered employee becomes entitled to benefits under title XVIII of the Social Security Act."

(C) The amendments made by this paragraph shall apply to plan years beginning after December 31, 1989.

(6)(A) Section 3011(b)(6) of the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100—647) is repealed.

(B) Subparagraph (A) shall be effective as if included in the enactment of section 3011(b) of the Technical and Miscellaneous Revenue Act of 1988.

(d) AMENDMENTS RELATED TO SECTION 1898 OF THE REFORM ACT.—

(1)(A) Clause (ii) of section 417(a)(3)(B) (defining applicable period) is amended by striking subclause (V) and inserting at the end thereof the following new flush sentence:

"In the case of a participant who separates from service before attaining age 35, the applicable period shall be a reasonable period after separation.".

(B) Clause (ii) of section 205(c)(3)(B) of ERISA is amended by striking subclause (V) and inserting at the end thereof the following new flush sentence:

"In the case of a participant who separates from service before attaining age 35, the applicable period shall be a reasonable period after separation.".

(2) Section 1898(b)(8) of the Reform Act is amended by adding at the end thereof the following new subparagraph:

"(C) EFFECTIVE DATE.—The amendments made by this paragraph shall apply to distributions after the date of the enactment of this Act.".

(3) Section 205(h) of ERISA is amended—

(A) in paragraph (1), by striking "the term" and inserting "The term", and by striking "benefit," and inserting "benefit."; and

(B) in paragraph (3), by striking "the term" and inserting "The term".

(4) Subparagraph (B) of section 1898(d)(1) of the Reform Act is amended by striking "Paragraph (1)" and inserting "Subsection (e)(1)".

(5) Section 203(e)(1) of ERISA (as amended by section 1898(d)(1) of the Tax Reform Act of 1986) is further amended to read as follows:

"(e)(1) If the present value of any nonforfeitable benefit with respect to a participant in a plan exceeds $3,500, the plan shall provide that such benefit may not be immediately distributed without the consent of the participant.".

(6) Subclause (IV) of section 205(c)(3)(B)(ii) of ERISA is amended by striking "401(a)(11)" and inserting "205".

(7) Subparagraph (B) of section 1898(b)(7) of the Reform Act is amended by striking "Subparagraph (C) of section 205(b)(1)" and inserting "Clause (i) of section 205(b)(1)(C)".

(8) Section 205(e)(2) of ERISA is amended by striking "nonforfeitable accrued benefit" and inserting "nonforfeitable right (within the meaning of section 203)".

(9)(A) Subparagraph (B) of section 1898(b)(14) of the Reform Act is amended by inserting "(as amended by section 1145(b))" after "1974".

(B) Paragraph (3) of section 205(b) of ERISA (as added by section 1898(b)(14)(B) of the Reform Act) is redesignated as paragraph (4).

(10) Section 203(e)(1) of ERISA is amended by striking "vested accrued benefit" and inserting "nonforfeitable benefit".

SEC. 7863. EFFECTIVE DATE.

Except as otherwise provided in this subpart, any amendment made by this subpart shall take effect as if included in the provision of the Reform Act to which such amendment relates.

Subpart B—Amendments Related to Omnibus Budget Reconciliation Act of 1986

SEC. 7871. AMENDMENTS RELATED TO OMNIBUS BUDGET RECONCILIATION ACT OF 1986.

(a) AMENDMENTS RELATED TO SECTION 9202 OF THE ACT.—

(1) Section 411(b)(2) of the Internal Revenue Code of 1986 and section 204(b)(2) of ERISA are each amended by striking subparagraph (B) and by redesignating subparagraphs (C) and (D) as subparagraphs (B) and (C), respectively.

(2) Section 411(b)(2(C), as redesignated by paragraph (1), is amended by striking "subparagraph" and inserting "paragraph".

(3) Section 204(b)(2)(C) of ERISA, as redesignated by paragraph (1), is amended by striking "(C) and (D)" and inserting "(B) and (C)".

(4) The amendments made by this subsection shall take effect as if included in the amendments made by section 9202 of the Omnibus Budget Reconciliation Act of 1986.

(b) AMENDMENTS RELATED TO SECTION 9203 OF THE ACT.—

(1) Section 411(a)(8)(B) is amended to read as follows:

"(B) the later of—

"(i) the time a plan participant attains age 65, or

"(ii) the 5th anniversary of the time a plan participant commenced participation in the plan."

(2) Section 3(24)(B) of ERISA is amended to read as follows:

"(B) the later of—

"(i) the time a plan participant attains age 65, or

"(ii) the 5th anniversary of the time a plan participant commenced participation in the plan."

(3) The amendments made by this subsection shall take effect as if included in the amendments made by section 9203 of the Omnibus Budget Reconciliation Act of 1986.

(c) AMENDMENT RELATING TO SECTION 9501.—Section 602(2)(A)(iii) of ERISA is amended by inserting "section" before "603(6)".

Subpart C—Amendments Related to Pension Protection Act

SEC. 7881. AMENDMENTS RELATED TO PENSION PROTECTION ACT.

(a) AMENDMENTS RELATED TO SECTION 9303.—

(1)(A) Subclause (II) of section 412(l)(3)(C)(ii) is amended by inserting "(but not below zero)" after "reducing".

(B) Subclause (II) of section 302(d)(3)(C)(ii) of ERISA is amended by inserting "(but not below zero)" after "reducing".

(2)(A) Clause (i) of section 412(l)(4)(B) is amended by inserting "and the unamortized portion of the unfunded existing benefit increase liability" after "liability".

(B) Clause (i) of section 302(d)(4)(B) of ERISA is amended by inserting "and the unamortized portion of the unfunded existing benefit increase liability" after "liability".

(3)(A) Section 412(l)(5)(C) is amended by striking "October 17, 1987" and inserting "the first plan year beginning after December 31, 1988".

(B) Section 302(d)(5)(C) of ERISA is amended by striking "October 17, 1987" and inserting "the first plan year beginning after December 31, 1988".

(4)(A) Section 412(l)(7)(D) is amended—

(i) by striking "and" at the end of clause (iii)(I), by striking the period at the end of clause (iii)(II) and inserting ", and", and by adding at the end of clause (iii) the following new subclause:

"(III) has years of service greater than the minimum years of service necessary for eligibility to participate in the plan.", and

(ii) by adding at the end thereof the following new clause:

"(iv) ELECTION.—An employer may elect not to have this subparagraph apply. Such an election, once made, may be revoked only with the consent of the Secretary.".

(B) Section 302(d)(7)(D) of ERISA is amended—

(i) by striking "and" at the end of clause (iii)(I), by striking the period at the end of clause (iii)(II) and inserting ", and", and by adding at the end of clause (iii) the following new subclause:

"(III) has years of service greater than the minimum years of service necessary for eligibility to participate in the plan.", and

(ii) by adding at the end thereof the following new clause:

"(iv) ELECTION.—An employer may elect not to have this subparagraph apply. Such an election, once made, may be revoked only with the consent of the Secretary of the Treasury.".

(5)(A) Section 412(l)(8) is amended—

(i) by striking "reduced by any credit balance in the funding standard account" in subparagraph (A)(ii), and

(ii) by adding at the end thereof the following new subparagraph:

"(E) DEDUCTION FOR CREDIT BALANCES.—For purposes of this subsection, the amount determined under subparagraph (A)(ii) shall be reduced by any credit balance in the funding standard account. The Secretary may provide for such reduction for purposes of any other provision which references this subsection.".

(B) Section 302(d)(8) of ERISA is amended—

(i) by striking "reduced by any credit balance in the funding standard account" in subparagraph (A)(ii), and

(ii) by adding at the end thereof the following new subparagraph:

"(E) DEDUCTION FOR CREDIT BALANCES.—For purposes of this subsection, the amount determined under subparagraph (A)(ii) shall be reduced by any credit balance in the funding standard account. The Secretary of the Treasury may provide for such reduction for purposes of any other provision which references this subsection.".

(6)(A) Section 412(c)(9) is amended—

(i) by striking "3 years" and inserting "year", and

(ii) by striking "3-YEAR" in the heading and inserting "ANNUAL".

(B) Section 302(c)(9) of ERISA is amended by striking "3 years" and inserting "year".

(7) Subclause (II) of section 9303(e)(3)(C)(ii) of the Pension Protection Act is amended by inserting "(and any income allocable to such amount)" after "clause (i)".

(b) AMENDMENTS RELATED TO SECTION 9304.—

(1)(A) Subparagraph (A) of section 412(c)(10) is amended—

(i) by inserting "defined benefit" before "plan other", and

(ii) by striking "PLANS" in the heading and inserting "DEFINED BENEFIT PLANS".

(B) Subparagraph (A) of section 302(c)(10) of ERISA is amended by inserting "defined benefit" before "plan other".

(2)(A) Subparagraph (B) of section 412(c)(10) is amended—

(i) by striking "multiemployer plan" and inserting "plan not described in subparagraph (A)", and

(ii) by striking "MULTIEMPLOYER" in the heading and inserting "OTHER".

(B) Subparagraph (B) of section 302(c)(10) of ERISA is amended by striking "multiemployer plan" and inserting "plan not described in subparagraph (A)".

(3)(A) Section 412(m)(1) is amended by inserting "defined benefit" before "plan (other".

(B) Section 302(e)(1) of ERISA is amended by inserting "defined benefit" before "plan (other".

(4)(A) Subparagraph (D) of section 412(m)(4) is amended to read as follows:

"(D) SPECIAL RULES FOR UNPREDICTABLE CONTINGENT EVENT BENEFITS.—In the case of a plan to which subsection (l) applies for any calendar year and which has any unpredictable contingent event benefit liabilities—

"(i) LIABILITIES NOT TAKEN INTO ACCOUNT.—Such liabilities shall not be taken into account in computing the required annual payment under subparagraph (B).

"(ii) INCREASE IN INSTALLMENTS.—Each required installment shall be increased by the greater of—

"(I) the unfunded percentage of the amount of benefits described in subsection (l)(5)(A)(i) paid during the 3-month period preceding the month in which the due date for such installment occurs, or

"(II) 25 percent of the amount determined under subsection (l)(5)(A)(ii) for the plan year.

"(iii) UNFUNDED PERCENTAGE.—For purposes of clause (ii)(I), the term 'unfunded percentage' means the percentage determined under subsection (l)(5)(A)(i)(I) for the plan year.

"(iv) LIMITATION ON INCREASE.—In no event shall the increases under clause (ii) exceed the amount necessary to increase the funded current liability percentage (within the meaning of subsection (l)(8)(B)) for the plan year to 100 percent."

(B) Subparagraph (D) of section 302(e)(4) of ERISA is amended to read as follows:

"(D) SPECIAL RULES FOR UNPREDICTABLE CONTINGENT EVENT BENEFITS.—In the case of a plan to which subsection (d) applies for any calendar year and which has any unpredictable contingent event benefit liabilities—

"(i) LIABILITIES NOT TAKEN INTO ACCOUNT.—Such liabilities shall not be taken into account in computing the required annual payment under subparagraph (B).

"(ii) INCREASE IN INSTALLMENTS.—Each required installment shall be increased by the greater of—

"(I) the unfunded percentage of the amount of benefits described in subsection (d)(5)(A)(i) paid during the 3-month period preceding the month in which the due date for such installment occurs, or

"(II) 25 percent of the amount determined under subsection (d)(5)(A)(ii) for the plan year.

"(iii) UNFUNDED PERCENTAGE.—For purposes of clause (ii)(I), the term 'unfunded percentage' means the percentage determined under subsection (d)(5)(A)(i)(I) for the plan year.

"(iv) LIMITATION ON INCREASE.—In no event shall the increases under clause (ii) exceed the amount necessary to increase the funded current liability percentage (within the meaning of subsection (d)(8)(B)) for the plan year to 100 percent.".

(5)(A) Section 101(d)(1) of ERISA is amended by striking "an employer of a plan" and inserting "an employer maintaining a plan".

(B) Section 502(c) of ERISA is amended by adding at the end thereof the following new paragraph:

"(3) Any employer maintaining a plan who fails to meet the notice requirement of section 101(d) with respect to any participant or beneficiary may in the court's discretion be liable to such participant or beneficiary in the amount of up to $100 a day from the date of such failure, and the court may in its discretion order such other relief as it deems proper.".

(C) Section 9304(d) of the Pension Protection Act is amended by striking "Section" and inserting "Effective with respect to plan years beginning after December 31, 1987, section".

(6)(A)(i) Subparagraph (B) of section 412(m)(1) is amended to read as follows:

"(B) the rate of interest used under the plan in determining costs (including adjustments under subsection (b)(5)(B)).".

(ii) Clause (ii) of section 412(d)(1)(A) is amended by inserting "(including adjustments under subsection (b)(5)(B))" after "costs".

(B)(i) Subparagraph (B) of section 302(e)(1) of ERISA is amended to read as follows:

"(B) the rate of interest used under the plan in determining costs (including adjustments under subsection (b)(5)(B)).".

(ii) Section 303(a)(1)(B) of ERISA (as redesignated by subsection (e)(2)) is amended by inserting "(including adjustments under section 302(b)(5)(B))" after "costs".

(7) Section 303(a) of ERISA (as amended by section 9306(c)(2)(A) of the Pension Protection Act) is amended—

(A) by redesignating subparagraphs (A) and (B) as paragraphs (1) and (2), respectively, and by adjusting the left-hand margination thereof 4 ems to the left;

(B) in paragraph (1) (as redesignated), by redesignating clauses (i) and (ii) as subparagraphs (A) and (B), respectively; and

(C) in paragraph (2) (as redesignated), by inserting "of such Code" after "section 6621(b)".

(8) Subsection (f) of section 303 of ERISA (as so redesignated by section 9306(a)(2) of the Pension Protection Act) is transferred to immediately after subsection (e) of such section.

(c) AMENDMENTS RELATED TO SECTION 9306.—

(1) The last sentence of section 412(f)(4)(A) is amended by striking "the benefit liabilities" and inserting "for benefit liabilities".

(2) The last sentence of section 303(e)(1) of ERISA is amended by striking "the benefit liabilities" and inserting "for benefit liabilities".

(3) Section 9306(f)(3) of the Pension Protection Act is amended to read as follows:

"(3) SUBSECTION (b).—The amendments made by subsection (b) shall apply to waivers for plan years beginning after December 31, 1987. For purposes of applying such amendments, the number of waivers which may be granted for plan years after December 31, 1987, shall be determined without regard to any waivers granted for plan years beginning before January 1, 1988.".

(d) AMENDMENTS RELATED TO SECTION 9307.—

(1)(A) Clause (iii) of section 412(b)(5)(B) is amended by striking for purposes of this section and for purposes of determining current liability,".

(B) Clause (iii) of section 302(b)(5)(B) of ERISA is amended by striking "for purposes of this section and for purposes of determining current liability,".

(2)(A) Section 302(b)(5)(B) of ERISA is amended by inserting the following matter after the heading and before clause (i): "For purposes of determining a plan's required contribution under section 302(d) for any plan year—".

(B) Section 302(b)(5) of ERISA is amended by striking the matter following the heading thereof and preceding subparagraph (A).

(C) Subclause (I) of section 302(b)(5)(B)(ii) of ERISA is amended by striking "average rate" and inserting "the weighted average of the rates".

(3) Section 9307(f) of the Pension Protection Act is amended to read as follows:

"(f) EFFECTIVE DATE.—

"(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to years beginning after December 31, 1987.

"(2) AMORTIZATION OF GAINS AND LOSSES.—Sections 412(b)(2)(B)(iv) and 412(b)(3)(B)(ii) of the Internal Revenue Code of 1986 and sections 302(b)(2)(B)(iv) and 302(b)(3)(B)(ii) of the Employee Retirement Income Security Act of 1974 (as amended by paragraphs (1)(A) and (2)(A) of subsection (a)) shall apply to gains and losses established in years beginning after December 31, 1987. For purposes of the preceding sentence, any gain or loss determined by a valuation occurring as of January 1, 1988, shall be treated as established in years beginning before 1988, or at the election of the employer, shall be amortized in accordance with Internal Revenue Service Notice 89-52.".

(4) Subparagraphs (A) and (B) of section 302(c)(3) of ERISA are each amended by adjusting the left-hand margination thereof, and of each subdivision thereof, 2 ems to the left.

(e) AMENDMENTS RELATED TO SECTION 9311.—

(1) Section 9311(a)(2) of the Pension Protection Act is amended by striking "plan assets to the employer for purposes of section 4044(d)(1)(C) of the Employee Retirement Income Security Act of 1974" and inserting "residual plan assets upon termination".

(2) Section 9311(d) of the Pension Protection Act is amended—

(A) by striking "section 4041(c)" and inserting "section 4041" in paragraph (1), and

(B) by adding at the end thereof the following new flush sentence:

"Except as provided in subsection (a)(2), the amendments made by subsection (a) shall apply to any provision of the plan or plan amendment adopted after December 17, 1987.".

(3) Section 9311(b)(2) of the Pension Protection Act is amended by striking "subsection (c)(1)" and inserting "subsection (a)(1)".

(4) Section 9311(a)(2) of the Pension Protection Act is amended—

(A) by striking "1 year after the effective date of such amendments made by paragraph (1)" and inserting "December 17, 1988"; and

(B) by striking the last sentence.

(f) AMENDMENTS RELATED TO SECTION 9312.—

(1) Section 9312(b)(3)(B)(i) of the Pension Protection Act is amended—

(A) by striking "section 4022(c)(1)" in subclause (I) and inserting "section 4022(c)(3)", and

(B) by striking "subparagraph (B) of section 4022(c)(1)" and inserting "subparagraph (C) of section 4022(c)(3)".

(2) Section 4062(a) of ERISA is amended—

(A) by inserting "and" at the end of paragraph (1);

(B) by striking paragraph (2);

(C) by redesignating paragraph (3) as paragraph (2); and

(D) in paragraph (2) (as so redesignated), by striking "subsection (d)" and inserting "subsection (c)".

(3)(A) Section 4064(b) of ERISA is amended by striking "and clauses (i)(II) and (ii) of section 4062(b)(1)(A)" and inserting "and section 4068(a)".

(B) Section 4068(a) of ERISA is amended by striking the last sentence.

(4) Section 4022(c)(1) of ERISA is amended by striking "(in the case of a deceased participant)".

(5) Section 4022(c)(3)(B)(ii) of ERISA is amended by inserting ", and during the 5-Federal fiscal year period ending with the fiscal year preceding the fiscal year in which occurs the date of the notice of intent to terminate with respect to the plan termination for which the recovery ratio is being determined" after "1987".

(6) Section 9312(b)(3)(B) of the Pension Protection Act is amended by striking clause (ii).

(7) Section 4041(c) of ERISA is amended—

(A) by striking "(or its designee under section 4049(b))" in paragraph (2)(A)(iii)(II),

(B) by striking "section 4049" in paragraph (2)(A)(iii)(II) and inserting "section 4022(c)", and

(C) by striking the last sentence of paragraph (3)(C)(i).

(8) Section 4070(a) of ERISA is amended by striking "4049,".

(9) Section 9312(d)(1) of the Pension Protection Act is amended by striking "section 4041(c)" and inserting "section 4041".

(10)(A) Section 4062(b)(2)(B) of ERISA is amended by striking "the liability under paragraph (1)(A)(ii)" and inserting "so much of the liability under paragraph (1)(A) as exceeds 30 percent of the collective net worth of all persons described in subsection (a) (including interest)".

(B) Section 9312(b)(2)(B)(ii) of the Pension Protection Act is amended to read as follows:

"(ii) Section 4062(d) of ERISA (as redesignated by paragraph (1)(B)) is amended by striking out paragraph (3).".

(C) Section 4068 of ERISA is amended by adding at the end the following new subsection:

"(f) DEFINITIONS.—For purposes of this section—

"(1) The collective net worth of persons subject to liability in connection with a plan termination shall be determined as provided in section 4062(d)(1).

"(2) The term 'pre-tax profits' has the meaning provided in section 4062(d)(2).".

(11) Section 4022(c)(1) of ERISA is amended by striking "section 4044(a), to such participant" and inserting "section 4044(a). Such payment shall be made to such participant".

(12) Subsection (a) of section 4068 of ERISA is amended—

(A) by striking "to the extent such amount does not exceed 30 percent of the collective net worth of all persons described in section 4062(a)" the first place it appears; and

(B) by striking "to the extent such amount does not exceed 30 percent of the collective net worth of all persons described in section 4062(a)" the second place it appears and all that follows and inserting the following: "in the amount of such liability (including interest) upon all property and rights to property, whether real or personal, belonging to such person, except that such lien may not be in an amount in excess of 30 percent of the collective net worth of all persons described in section 4062(a)".

(13) The table of contents in section 1 of ERISA is amended by striking the item relating to section 4049.

(g) AMENDMENTS RELATED TO SECTION 9313.—

(1) Section 4041(d)(1) of ERISA is amended by striking "sufficient for benefit commitments" and inserting "sufficient for benefit liabilities".

(2) Section 4041(c)(2)(B) of ERISA is amended by inserting "proposed" before "termination" in the parenthetical in the second sentence.

(3) Clause (ii) of section 4041(c)(2)(A) of ERISA is amended—

(A) by inserting "unless the corporation determines the information is not necessary for purposes of paragraph (3)(A) or section 4062," before "certification",

(B) by inserting "and, if applicable, the proposed distribution date" after "termination date" in subclause (I), and

(C) by striking "date" and inserting "dates" in subclauses (II) through (V).

(4) Subparagraph (B) of section 4041(b)(3) of ERISA is amended by adding a period at the end.

(5) Section 9313(b)(3) of the Pension Protection Act is amended by inserting "each place it appears" before the period.

(6) Section 4041(b)(2)(A) of ERISA is amended by adjusting the left-hand margination of the last sentence two ems to the right.

(7) The first subsection (b) of section 9314 of the Pension Protection Act is amended by striking "Section 4042" and inserting "Section 4042(a)", and by striking "third sentence" and inserting "last sentence".

(8) Section 9314(c)(1) of the Pension Protection Act is amended by inserting "title IV of" after "Subtitle D of".

(h) AMENDMENT RELATED TO SECTION 9331.—

(1) Subparagraph (E) of section 4006(a)(3) of ERISA is amended by adding at the end thereof the following new clause:

"(v) No premium shall be determined under this subparagraph for any plan year if, as of the close of the preceding plan year, contributions to the plan for the preceding plan year were not less than the full funding limitation for the preceding plan year under section 412(c)(7) of the Internal Revenue Code of 1986.".

(2) Clause (iii) of section 4006(c)(1)(A) of ERISA is amended by adjusting the left-hand margination thereof 2 ems to the left.

(i) AMENDMENTS RELATED TO SECTION 9341.—

(1)(A) Section 401(a)(29)(C)(i)(II) is amended by inserting "and any other plan amendments adopted after December 22, 1987, and before such plan amendment" after "amendment".

(B) Section 307(c)(1)(B) of ERISA is amended by inserting "and any other plan amendments adopted after December 22, 1987, and before such plan amendment".

(2) Section 307(d) of ERISA is amended by inserting "of the Treasury" after "Secretary".

(3)(A) Section 307 of ERISA is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) NOTICE.—A contributing sponsor which is required to provide security under subsection (a) shall notify the Pension Benefit Guaranty Corporation within 30 days after the amendment requiring such security takes effect. Such notice shall contain such information as the Corporation may require.".

(B) Section 4071 of ERISA is amended—

(i) by striking "or subtitle A, B, or C" and inserting ", subtitle A, B, or C, as section 302(f)(4) or 307(e)", and

(ii) by inserting "or such section" after "such subtitle".

(4)(A) Clause (i) of section 401(a)(29)(A) is amended by inserting "to which the requirements of section 412 apply" after "multiemployer plan)".

(B) Section 307(a)(1) of ERISA is amended by inserting "to which the requirements of section 302 apply" after "multiemployer plan)".

(5) Section 9341(c) of the Pension Protection Act is amended by inserting "(without regard to any extension, amendment, or modification of such agreements on or after such date of enactment)" after "ratified before the date of enactment".

(j) AMENDMENTS RELATED TO SECTION 9342.—

(1) Paragraph (11) of section 103(d) of ERISA is amended—

(A) by striking "60 percent" and inserting "70 percent", and

(B) by striking "such percentage" and inserting "the percentage which such value is of such liability.".

(2) Section 502(a)(6) of ERISA is amended by striking "subsection (i)" and inserting "subsection (c)(2) or (i)".

(3) Section 502(c)(2) of ERISA is amended—

(A) by inserting "against any plan administrator" after "civil penalty", and

(B) by striking "a plan administrator's" and inserting "such plan administrator's".

(4) Paragraph (2) of section 413 of ERISA is amended by striking the comma.

(k) AMENDMENT RELATED TO SECTION 9343.—Section 403(c) of ERISA

is amended by striking paragraph (3) and by redesignating paragraph (4) as paragraph (3).

(l) AMENDMENTS RELATED TO SECTION 9345.—

(1) Section 407(d)(3)(C) of ERISA is amended by adjusting the left-hand margination thereof 2 ems to the left.

(2) Section 407(d)(9) of ERISA is amended—

(A) by striking "such arrangement" and inserting "such individual account plan"; and

(B) by adjusting the left-hand margination thereof 2 ems to the right.

(3) Section 407(f) of ERISA is amended—

(A) in paragraph (1), by striking "this subsection" and inserting "this paragraph"; and

(B) by striking paragraph (3).

(4) Section 407(f)(1) of ERISA is amended by inserting ", immediately following the acquisition of such stock" after "if".

(5) Section 408(b) of ERISA is amended by adding at the end the following new paragraph:

"(12) The sale by a plan to a party in interest on or after December 18, 1987, of any stock, if—

"(A) the requirements of paragraphs (1) and (2) of subsection (e) are met with respect to such stock,

"(B) on the later of the date on which the stock was acquired by the plan, or January 1, 1975, such stock constituted a qualifying employer security (as defined in section 407(d)(5) as then in effect), and

"(C) such stock does not constitute a qualifying employer security (as defined in section 407(d)(5) as in effect at the time of the sale).".

(m) AMENDMENTS RELATED TO SECTION 9346.—

(1)(A) Clause (iii) of section 411(c)(2)(C) is amended to read as follows:

"(iii) interest on the sum of the amounts determined under clauses (i) and (ii) compounded annually—

"(I) at the rate of 120 percent of the Federal mid-term rate (as in effect under section 1274 for the 1st month of a plan year) for the period beginning with the 1st plan year to which subsection (a)(2) applies (by reason of the applicable effective date) and ending with the date on which the determination is being made, and

"(II) at the interest rate which would be used under the plan under section 417(e)(3) (as of the determination date) for the period beginning with the determination date and ending on the date on which the employee attains normal retirement age.".

(B) Subparagraph (B) of section 411(c)(2) is amended to read as follows:

"(B) DEFINED BENEFIT PLANS.—In the case of a defined benefit plan, the accrued benefit derived from contributions made by an employee as of any applicable date is the amount equal to the employee's accumulated contributions expressed as an annual benefit commencing at normal retirement age, using an interest rate which would be used under the plan under section 417(e)(3) (as of the determination date).".

(C) Section 411(c)(2) is amended by striking subparagraph (E).

(D) Section 411(a)(7) is amended by adding at the end thereof the following new subparagraph:

"(D) ACCRUED BENEFIT ATTRIBUTABLE TO EMPLOYEE CONTRIBUTIONS.—The accrued benefit of an employee shall not be less than the amount determined under subsection (c)(2)(B) with respect to the employee's accumulated contributions.".

(2)(A) Clause (iii) of section 204(c)(2)(C) of ERISA is amended to read as follows:

"(iii) interest on the sum of the amounts determined under clauses (i) and (ii) compounded annually—

"(I) at the rate of 120 percent of the Federal mid-term rate (as in effect under section 1274 of the Internal Revenue Code of 1986 for the 1st month of a plan year for the period beginning with the 1st plan year to which subsection (a)(2) applies by reason of the applicable effective date) and ending with the date on which the determination is being made, and

"(II) at the interest rate which would be used under the plan under section 205(g)(3) (as of the determination date) for the period beginning with the determination date and ending on the date on which the employee attains normal retirement age.".

(B) Subparagraph (B) of section 204(c)(2) of ERISA is amended to read as follows:

"(B) DEFINED BENEFIT PLANS.—In the case of a defined benefit plan, the accrued benefit derived from contributions made by an employee as of any applicable date is the amount equal to the employee's accumulated contributions expressed as an annual benefit commencing at normal retirement age, using an interest rate which would be used under the plan under section 205(g)(3) (as of the determination date).".

(C) Section 204(c)(2) of ERISA is amended by striking subparagraph (E).

(D) Paragraph (23) of section 3 of ERISA is amended by adding at the end thereof the following new flush sentence:

"The accrued benefit of an employee shall not be less than the amount determined under section 204(c)(2)(B) with respect to the employee's accumulated contribution.".

(3) If—

(A) during the period beginning December 22, 1987, and ending June 21, 1988, a plan was amended to reflect the amendments made by section 9346 of the Pension Protection Act, and

(B) such plan is amended to reflect the amendments made by this subsection,

any plan amendment described in subparagraph (B) shall not be treated as reducing accrued benefits for purposes of section 411(d)(6) of the Internal Revenue Code of 1986 or section 204(g) of ERISA.

SEC. 7882. EFFECTIVE DATE

Except as otherwise provided in this subpart, any amendment made by this subpart shall take effect as if included in the provision of the Pension Protection Act to which such amendment relates.

Subpart D—Additional Pension Provisions

SEC. 7891. AMENDMENTS RELATING TO THE TAX REFORM ACT OF 1986.

(a) AMENDMENTS RELATED TO SECTION 2.—

(1) Titles I, III, and IV of ERISA (other than sections 3(37)(E), 301(a)(7), and 308, the last sentence of section 408(d), and sections 414(c), 4001(a)(3)(ii), and 4303) are each amended by striking "Internal Revenue Code of 1954" each place it appears and inserting "Internal Revenue Code of 1986".

(2) The last sentence of section 408(d) of ERISA (as amended by section 7894(e)(4)(A)(i)) is further amended—

(A) by striking "section 408 of the Internal Revenue Code of 1954" and inserting "section 408 of the Internal Revenue Code of 1986"; and

(B) by striking "section 408(c) of such Code" and inserting "section 408(c) of the Internal Revenue Code of 1986".

(b) AMENDMENTS RELATED TO SECTION 1139.—

(1) Paragraphs (2)(A) and (2)(B) of section 203(e) of ERISA are each amended by adjusting the margination thereof, and of each subdivision thereof, 2 ems to the left.

(2) Subparagraph (B) of section 203(e)(2) of ERISA is amended by striking "APPLICABLE INTEREST RATE.—".

(3) Paragraph (3)(A) of section 205(g) of ERISA is amended by adjusting the left-hand margination thereof, and of each subdivision thereof, 2 ems to the left.

(c) AMENDMENT RELATED TO SECTION 1145.—Paragraph (3) of section 205(b) of ERISA (as added by section 1145(b) of the Reform Act) is amended by adjusting the left-hand margination thereof 2 ems to the left.

(d) AMENDMENTS RELATED TO SECTION 1895.—

(1)(A)(i) Section 606 of ERISA is amended—

(I) in paragraph (2), by inserting after "30 days" the following: "(or, in the case of a group health plan which is a multiemployer plan, such longer period of time as may be provided in the terms of the plan)"; and

(II) in the first sentence following paragraph (4), by inserting after "14 days" the following: "(or, in the case of a group health plan which is a multiemployer plan, such longer period of time as may be provided in the terms of the plan)".

(ii) Section 606 of ERISA is amended—

(I) by inserting "(a) IN GENERAL.—" before "In accordance";

(II) by striking "For purposes of paragraph (4)," and inserting the following:

"(c) RULES RELATING TO NOTIFICATION OF QUALIFIED BENEFICIARIES BY PLAN ADMINISTRATOR.—For purposes of subsection (a)(4),"; and

(III) by inserting after subsection (a)(4) (as so designated by the amendment made by subclause (I)) the following new subsection:

"(b) ALTERNATIVE MEANS OF COMPLIANCE WITH REQUIREMENT FOR NOTIFICATION OF MULTIEMPLOYER PLANS BY EMPLOYERS.—The requirements of subsection (a)(2) shall be considered satisfied in the case of a multiemployer plan in connection with a qualifying event described in paragraph (2) of section 603 if the plan provides that the determination of the occurrence of such qualifying event will be made by the plan administrator.".

(B)(i) Section 4980B(f)(6) of the 1986 Code (as added by the Technical and Miscellaneous Revenue Act of 1988) is amended—

(I) in subparagraph (B), by inserting after "30 days" the following: "(or, in the case of a group health plan which is a multiemployer plan, such longer period of time as may be provided in the terms of the plan)"; and

(II) in the first sentence following subparagraph (D), by inserting after "14 days" the following: "(or, in the case of a group health plan which is a multiemployer plan, such longer period of time as may be provided in the terms of the plan)".

(ii) Section 4980B(f)(6) of the 1986 Code (as added by the Technical and Miscellaneous Revenue Act of 1988) is amended by inserting, after and below subparagraph (D), the following new flush sentence: "The requirements of subparagraph (B) shall be considered satisfied in the case of a multiemployer plan in connection with a qualifying event described in paragraph (3)(B) if the plan provides that the determination of the occurrence of such qualifying event will be made by the plan administrator.".

(C) The amendments made by this paragraph shall apply with respect to plan years beginning on or after January 1, 1990.

(2)(A) Section 4980B(f) of the 1986 Code (as added by the Technical and Miscellaneous Revenue Act of 1988) is amended by adding at the end the following new paragraph:

"(8) OPTIONAL EXTENSION OF REQUIRED PERIODS.—A group health plan shall not be treated as failing to meet the requirements of this subsection solely because the plan provides both—

"(A) that the period of extended coverage referred to in paragraph (2)(B) commences with the date of the loss of coverage, and

"(B) that the applicable notice period provided under paragraph (6)(B) commences with the date of the loss of coverage.".

(B)(i) Section 607 of ERISA is amended—

(I) in the heading, by inserting "AND SPECIAL RULES" after "DEFINITIONS"; and

(II) by adding at the end the following new paragraph:

"(5) OPTIONAL EXTENSION OF REQUIRED PERIODS.—A group health plan shall not be treated as failing to meet the requirements of this part solely because the plan provides both—

"(A) that the period of extended coverage referred to in section 602(2) commences with the date of the loss of coverage, and

"(B) that the applicable notice period provided under section 606(a)(2) commences with the date of the loss of coverage.".

(ii) The item relating to section 607 in the table of contents in section 1 of ERISA is amended by inserting "and special rules" after "Definitions".

(C) The amendments made by this paragraph shall apply with respect to plan years beginning on or after January 1, 1990.

* * * * *

Subtitle B—Technical Provisions

SEC. 10201. PROHIBITION OF TERMINATION OF COVERAGE OF U.S. CITIZENS AND RESIDENTS EMPLOYED ABROAD BY A FOREIGN AFFILIATE OF AN AMERICAN EMPLOYER.

(a) IN GENERAL.—Subsection (l) of section 3121 of the Internal Revenue Code of 1986 (relating to agreements entered into by American employers with respect to foreign affiliates) is amended—

(1) in paragraph (2), by adding at the end the following: "Notwithstanding any other provision of this subsection, the period for which any such agreement is effective with respect to any foreign entity shall terminate at the end of any calendar quarter in which the foreign entity, at any time in such quarter, ceases to be a foreign affiliate as defined in paragraph (6).";

(2) by striking paragraphs (3), (4), and (5);

(3) by inserting after paragraph (2) the following new paragraph:

"(3) NO TERMINATION OF AGREEMENT.—No agreement under this subsection may be terminated, either in its entirety or with respect to any foreign affiliate, on or after June 15, 1989."; and

(4) by redesignating paragraphs (6) through (10) as paragraphs (4) through (8), respectively.

(b) CONFORMING AMENDMENTS.—(1) Subsection (a) of section 210 of the Social Security Act (42 U.S.C. 410(a)) and subsection (a) of section 406 of the Internal Revenue Code of 1986 (relating to treatment of employees of American employer) are each amended by striking "section 3121(l)(8)" and inserting "section 3121(l)(6)".

(2) Paragraph (3) of section 406(c) of the Internal Revenue Code of 1986 (relating to termination of status as deemed employee not be treated as separation from service for purposes of limitation of tax) is amended by striking "section 3121(l)(8)(B)" and inserting "section 3121(l)(6)(B)".

(3) Paragraph (1) of section 3121(l) of such Code (relating to agreements entered into by American employers with respect to foreign affiliates) is amended, in the matter preceding subparagraph (A), by striking "paragraph (8)" and inserting "paragraph (6)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to any agreement in effect under section 3121(l) of the Internal Revenue Code of 1986 on or after June 15, 1989, with respect to which no notice of termination is in effect on such date.

SEC. 10202. EXCLUSION FROM WAGES AND COMPENSATION OF REFUNDS REQUIRED FROM EMPLOYERS TO COMPENSATE FOR DUPLICATION OF MEDICARE BENEFITS BY HEALTH CARE BENEFITS PROVIDED BY THE EMPLOYERS.

(a) OLD-AGE, SURVIVORS, AND DISABILITY, AND HOSPITAL INSURANCE PROGRAMS.—For purposes of title II of the Social Security Act and chapter 21 of the Internal Revenue Code of 1986, the term "wages" shall not include the amount of any refund required under section 421 of the Medicare Catastrophic Coverage Act of 1988.

(b) RAILROAD RETIREMENT PROGRAM.—For purposes of chapter 22 of the Internal Revenue Code of 1986, the term "compensation" shall not include the amount of any refund required under section 421 of the Medicare Catastrophic Coverage Act of 1988.

(c) FEDERAL UNEMPLOYMENT PROGRAMS.—

(1) FEDERAL UNEMPLOYMENT TAX.—For purposes of chapter 23 of the Internal Revenue Code of 1986, the term "wages" shall not include the amount of any refund required under section 421 of the Medicare Catastrophic Coverage Act of 1988.

(2) RAILROAD UNEMPLOYMENT CONTRIBUTIONS.—For purposes of the Railroad Unemployment Insurance Act, the term "compensation" shall not include the amount of any refund required under section 421 of the Medicare Catastrophic Coverage Act of 1988.

(3) RAILROAD UNEMPLOYMENT REPAYMENT TAX.—For purposes of chapter 23A of the Internal Revenue Code of 1986, the term "rail wages" shall not include the amount of any refund required under section 421 of the Medicare Catastrophic Coverage Act of 1988.

(d) REPORTING REQUIREMENTS.—Any refund required under section 421 of the Medicare Catastrophic Coverage Act of 1988 shall be reported to the Secretary of the Treasury or his delegate and to the person to whom such refund is made in such manner as the Secretary of the Treasury or his delegate shall prescribe.

(e) EFFECTIVE DATE.—This section shall apply with respect to refunds provided on or after January 1, 1989.

SEC. 10203. ELIMINATION OF ANY CARRYOVER REDUCTION IN RETIREMENT OR DISABILITY BENEFITS DUE TO RECEIPT OF WIDOW'S OR WIDOWER'S BENEFITS BEFORE ATTAINING AGE 62.

(a) IN GENERAL.—Section 202(q)(3) of the Social Security Act (42 U.S.C. 402(q)(3)) is amended—

(1) by striking subparagraphs (E), (F), and (G); and

(2) by redesignating subparagraph (H) as subparagraph (E).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply—

(1) in the case of any individual's old-age insurance benefit referred to in section 202(q)(3)(E) of the Social Security Act (as in effect before the amendments made by this section), only if such individual attains age 62 on or after January 1, 1990, and

(2) in the case of any individual's disability insurance benefit referred to in section 202(q)(3)(F) or (G) of such Act (as so in effect), only if such individual both attains age 62 and becomes disabled on or after such date.

SEC. 10204. CLARIFICATION OF RULES GOVERNING TAXATION UNDER FICA AND SECA OF INDIVIDUALS OF CERTAIN RELIGIOUS FAITHS.

(a) EXEMPTION FROM SECA TAXATION FOR CERTAIN EMPLOYEES EXEMPT FROM FICA TAXATION.—

(1) IN GENERAL.—Paragraph (3) of section 1402(g) of the Internal Revenue Code of 1986 (relating to inapplicability of exemption to certain church employees) is amended—

(A) in the heading, by striking "NOT TO APPLY" and inserting "TO APPLY"; and

(B) by striking "shall not" and inserting "shall".

(2) EFFECTIVE DATE.—The amendments made by paragraph (1) shall apply with respect to taxable years beginning after December 31, 1989.

(b) TECHNICAL AMENDMENT CLARIFYING INCLUSION OF PARTNERSHIPS AMONG EMPLOYERS ELIGIBLE FOR RELIGIOUS EXEMPTION FROM FICA.—

(1) IN GENERAL.—Section 3127 of the Internal Revenue Code of 1986 (relating to exemption for employers and their employees where both are members of religious faiths opposed to participation in Social Security Act programs) is amended—

(A) in subsection (a)(1), by inserting "(or, if the employer is a partnership, each partner therein)" after "an employer";

(B) in subsection (a), in the matter following paragraph (2), by striking "his employees" and inserting "the employees thereof";

(C) in subsection (b), by inserting "(or a partner)" after "an employer";

(D) in subsection (c), by striking "his employees" and inserting "the employees thereof";

(E) in subsection (c)(1), by inserting "(or, if the employer is a partnership, each partner therein)" after "such employer"; and

(F) in subsection (c)(2), by striking "such employer or the employee involved ceases to meet" and inserting "such employer (or, if the employer is a partnership, any partner therein) or the employee involved does not meet", and by inserting "(or, if the employer is a partnership, any partner therein)" after "such employer" the second place it appears.

(2) EFFECTIVE DATE.—The amendments made by this subsection shall be effective as if they were included in the amendments made by section 8007(a)(1) of the Technical and Miscellaneous Revenue Act of 1988 (102 Stat. 3781).

SEC. 10205. TREATMENT OF GROUP-TERM LIFE INSURANCE UNDER RAILROAD RETIREMENT TAXES.

(a) IN GENERAL.—The second sentence of section 3231(e)(1) of the Internal Revenue Code of 1986 (defining compensation) is amended by striking ", (ii) tips" and inserting "or death, except that this clause does not apply to a payment for group-term life insurance to the extent that such payment is includible in the gross income of the employee, (ii) tips".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by subsection (a) shall apply to—

(A) group-term life insurance coverage in effect after December 31, 1989, and

(B) remuneration paid before January 1, 1990, which the employer treated as compensation when paid.

(2) EXCEPTION.—The amendment made by subsection (a) shall not apply with respect to payments by the employer (or a successor of such employer) for group-term life insurance for such employer's former employees who separated from employment with the employer on or before December 31, 1989, to the extent that such payments are not for coverage for any such employee for any period for which such employee is employed by such employer (or a successor of such employer) after the date of such separation.

(3) BENEFIT DETERMINATIONS TO TAKE INTO ACCOUNT REMUNERATION ON WHICH TAX PAID.—The term "compensation" as defined in section 1(h) of the Railroad Retirement Act of 1974 includes any remuneration which is included in the term "compensation" as defined in section 3231(e)(1) of the Internal Revenue Code of 1986 by reason of the amendment made by subsection (a).

SEC. 10206. TREATMENT OF CERTAIN DEFERRED COMPENSATION AND SALARY REDUCTION ARRANGEMENTS UNDER RAILROAD RETIREMENT TAXES.

(a) IN GENERAL.—The second sentence of section 3231(e)(1) of the Internal Revenue Code of 1986 (defining compensation) is amended by striking "or (iii)" and inserting "(iii)" and by inserting before the period ", or (iv) any remuneration which would not (if chapter 21 applied to such remuneration) be treated as wages (as defined in section 3121(a)) by reason of section 3121(a)(5)".

(b) TREATMENT OF CERTAIN DEFERRED COMPENSATION AND SALARY REDUCTION ARRANGEMENTS.—Subsection (e) of section 3231 of such Code is amended by adding at the end thereof the following new paragraph:

"(9) TREATMENT OF CERTAIN DEFERRED COMPENSATION AND SALARY REDUCTION ARRANGEMENTS.—

"(A) CERTAIN EMPLOYER CONTRIBUTIONS TREATED AS COMPENSATION.—Nothing in any paragraph of this subsection (other than paragraph (2)) shall exclude from the term 'compensation' any amount described in subparagraph (A) or (B) of section 3121(v)(1).

"(B) TREATMENT OF CERTAIN NONQUALIFIED DEFERRED COMPENSATION.—The rules of section 3121(v)(2) which apply for purposes of chapter 21 shall also apply for purposes of this chapter.".

(c) EFFECTIVE DATES.—

(1) SUBSECTION (a).—The amendment made by subsection (a) shall apply to remuneration paid after December 31, 1989.

(2) SUBSECTION (b).—Except as otherwise provided in this subsection—

(A) IN GENERAL.—The amendment made by subsection (b) shall apply to—

(i) remuneration paid after December 31, 1989, and

(ii) remuneration paid before January 1, 1990, which the employer treated as compensation when paid.

(B) BENEFIT DETERMINATIONS TO TAKE INTO ACCOUNT REMUNERATION ON WHICH TAX PAID.—The term "compensation" as defined in section 1(h) of the Railroad Retirement Act of 1974 includes any remuneration which is included in the term "compensation" as defined in section 3231(e)(1) of the Internal Revenue Code of 1986 by reason of the amendment made by subsection (b).

(3) SPECIAL RULE FOR CERTAIN PAYMENTS.—For purposes of applying the amendment made by subsection (b) to remuneration paid after December 31, 1989, which would have been taken into account before January 1, 1990, if such amendments had applied to periods before January 1, 1990, such remuneration shall be taken into account when paid (or, at the election of the payor, at the time which would be appropriate if such amendments had applied).

(4) EXCEPTION FOR CERTAIN 401(k) CONTRIBUTIONS.—The amendment made by subsection (b) shall not apply to employer contributions made during 1990 and attributable to services performed during 1989 under a qualified cash or deferred arrangement (as defined in section 401(k) of the Internal Revenue Code of 1986) if, under the terms of the arrangement as in effect on June 15, 1989—

(A) the employee makes an election with respect to such contributions before January 1, 1990, and

(B) the employer identifies the amount of such contribution before January 1, 1990.

(5) SPECIAL RULE WITH RESPECT TO NONQUALIFIED DEFERRED COMPENSATION PLANS.—In the case of an agreement in existence on June 15, 1989, between a nonqualified deferred compensation plan (as defined in section 3121(v)(2)(C) of such Code) and an individual, the amendment made by subsection (b) shall apply with respect to services performed by the individual after December 31, 1989. The preceding sentence shall not apply in the case of a plan to which section 457(a) of such Code applies.

SEC. 10207. TREATMENT OF ROWAN DECISION UNDER RAILROAD RETIREMENT TAXES.

(a) EXCLUSION OF MEALS AND LODGING.—Subsection (e) of section 3231 of the Internal Revenue Code of 1986 is further amended by adding at the end the following new paragraph:

"(10) MEALS AND LODGING.—The term 'compensation' shall not include the value of meals or lodging furnished by or on behalf of the employer if at the time of such furnishing it is reasonable to believe that the employee will be able to exclude such items from income under section 119.".

(b) INCOME TAX WITHHOLDING REGULATIONS NOT TO APPLY.—Paragraph (1) of section 3231(e) of such Code is amended by adding at the end the following new sentence: "Nothing in the regulations prescribed for purposes of chapter 24 (relating to wage withholding) which provides an exclusion from 'wages' as used in such chapter shall be construed to require a similar exclusion from 'compensation' in regulations prescribed for purposes of this chapter.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to remuneration paid after December 31, 1989.

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Part III. Administrative, Procedural and Miscellaneous

CONTENTS

Delegation Order 4 (Rev. 20) 294
Delegation Order 143 (Rev. 4) 295
Delegation Order 222 (Rev. 2) 296
Notice 90-1 297
Notice 90-2 301
Notice 90-3 303
Notice 90-4 303
Notice 90-5 303
Notice 90-6 304
Notice 90-7 304
Notice 90-8 305
Notice 90-9 312
Notice 90-10 319
Notice 90-11 319
Notice 90-12 321
Notice 90-13 321
Notice 90-14 322
Notice 90-15 326
Notice 90-16 326
Notice 90-17 327
Notice 90-18 327
Notice 90-19 328
Notice 90-20 328
Notice 90-21 332
Notice 90-22 334
Notice 90-23 335
Notice 90-24 335
Notice 90-25 336
Notice 90-26 336
Notice 90-27 336
Notice 90-28 339
Notice 90-29 340
Notice 90-30 340
Notice 90-31 341
Notice 90-32 341
Notice 90-33 341
Notice 90-34 341
Notice 90-35 342
Notice 90-36 342
Notice 90-37 343
Notice 90-38 345
Notice 90-39 349
Notice 90-40 350
Notice 90-41 350
Notice 90-42 356
Revenue Procedure 90-1 356
Revenue Procedure 90-2 386
Revenue Procedure 90-3 402
Revenue Procedure 90-3A 409
Revenue Procedure 90-4 410
Revenue Procedure 90-5 421
Revenue Procedure 90-6 430
Revenue Procedure 90-7 432
Revenue Procedure 90-8 434
Revenue Procedure 90-9 460
Revenue Procedure 90-10 467
Revenue Procedure 90-11 469
Revenue Procedure 90-12 471
Revenue Procedure 90-13 473
Revenue Procedure 90-14 473
Revenue Procedure 90-15 476
Revenue Procedure 90-16 477
Revenue Procedure 90-17 479
Revenue Procedure 90-18 491
Revenue Procedure 90-19 495
Revenue Procedure 90-20 495
Revenue Procedure 90-21 499
Revenue Procedure 90-22 504
Revenue Procedure 90-23 507
Revenue Procedure 90-24 510
Revenue Procedure 90-25 511
Revenue Procedure 90-26 512
Revenue Procedure 90-27 514
Revenue Procedure 90-28 518
Revenue Procedure 90-29 533
Revenue Procedure 90-30 534
Revenue Procedure 90-31 539
Revenue Procedure 90-32 546
Revenue Procedure 90-33 551
Revenue Procedure 90-34 552
Revenue Procedure 90-35 555
Social Security Contribution & Benefit Base 556

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 4 (Rev. 20) Effective March 5, 1990

Delegation of Authority

AGENCY: Internal Revenue Service

ACTION: The Delegation order is revised to change the position titles of Revenue Representative and Office Collection Representative to Tax Examiner, whose duties include contacting taxpayers in person. The order is also revised to include the position Revenue Officer in the list of delegated officials. This position was inadvertently excluded in previous revision of the order. Because the Austin Compliance Center has been made permanent, officials of that Center are now included as delegated officials.

Authority to Issue Summonses, to Administer Oaths and Certify, and to Perform other Functions

1(a) The authorities granted to the Commissioner of Internal Revenue by 26 CFR 301.7602-1(b), 301.7603-1, 301.7604-1 and 301.7605-1(a) and the authorities contained in Section 7609 of the Internal Revenue Code of 1954 and vested in the Commissioner of Internal Revenue Service by Treasury Order No. 150-10 to issue summonses; to set the time and place for appearance; to serve summonses; to take testimony under oath of the person summoned; to receive and examine books, papers, records or other data produced in compliance with the summons; to enforce summonses; to apply for court orders approving the service of John Doe Summonses issued under Section 7609(f) of the Internal Revenue Code; to apply for court orders suspending the notice requirements in the case of summonses issued under Section 7609(g) of the Internal Revenue Code; and under Section 7609(i)(2) of the Internal Revenue Code; may, when requested, certify to third-party recordkeepers that no action to quash has been timely initiated or that the taxpayer has consented to the examination of the records summonsed, are delegated to the officers and employees of the Internal Revenue Service specified in paragraphs 1(b), 1(c), and 1(d) of this Order and subject to the limitations stated in paragraphs 1(b), 1(c), 1(d), 5, and 6 of this Order.

1(b) The authorities to issue summonses and to perform the other functions related thereto specified in paragraph 1(a) of this Order, are delegated to all District Directors and the following officers and employees, provided that the authority to issue a summons in which the proper name or names of the taxpayer or taxpayers is not identified because unknown or unidentifiable (hereinafter called a "John Doe" summons) may be exercised only by said officers and employees.

(1) Inspection: Director, Internal Security Division and regional Inspectors.

(2) International: Deputy Assistant Commissioner and Directors, Offices of Taxpayer Service and Compliance, and International Programs.

(3) District Criminal Investigation: Chief of Division, except this authority in districts without a Division Chief is limited to the District Director.

(4) District Collection Activity: Chief of Division, except this authority in streamlined districts is limited to the District Director.

(5) District Examination: Chief of Division, except this authority in streamlined districts is limited to the District Director.

(6) District Employee Plans and Exempt Organizations: Chief of Division.

1(c) The authorities to issue summonses except "John Doe" summonses, and to perform other functions related thereto specified in paragraph 1(a) of this Order, are delegated to the following officers and employees:

(1) Inspection: Assistant Regional Inspectors (Internal Security) and Chief, Investigations Branch.

(2) Assistant Commissioner (International): Criminal Investigation Special Agents; Collection Group Managers; and Examination Group Managers (including large case managers).

(3) District Criminal Investigation: Assistant Chief of Division; and Special Agents.

(4) District Collection Activity: Assistant Chief of Division; Group Managers.

(5) District Examination: Case Managers, Group Managers (including large case managers) and, in streamlined districts Chiefs, Examination Section.

(6) District Employee Plans and Exempt Organizations: Group Managers.

1(d) The authority to issue summonses except "John Doe" summonses and to perform the other functions related thereto specified in paragraph 1(a) of this Order is delegated to the following officers and employees except that in the instance of a summons to a third party witness, the issuing officer's case manager, group manager, or any supervisory official above that level, has in advance personally authorized the issuance of the summons. Such authorization shall be manifested by the signature of the authorizing officer on the face of the original and all copies of the summons or by a statement on the face of the original and all copies of the summons, signed by the issuing officer, that he/she had prior authorization to issue said summons and stating the name and title of the authorizing official and the date of authorization.

(1) Assistant Commissioner (International): Internal Revenue Agents; Attorneys, Estate Tax; Estate Tax Examiners; Revenue Service and Assistant Revenue Service Representatives; Tax Auditors; and Revenue Officers, GS-9 and above.

(2) District Collection: Revenue Officers, GS-9 and above.

(3) District Examination: Internal Revenue Agents; Tax Auditors; Attorneys, Estate Tax; and Estate Tax Examiners.

(4) District Employee Plans and Exempt Organizations: Internal Revenue Agents; Tax Law Specialists; and Tax Auditors.

1(e) Each of the officers and employees referred to in paragraphs 1(b), 1(c), and 1(d) of this Order may serve a summons whether it is issued by him/her or another official.

1(f) Tax Examiners, GS-5 and above, whose duties include contacting taxpayers in person, Revenue Officer Aides, GS-5 and above, and Revenue Officers, who are assigned to the district or International Collec-

tion activity may serve any summons issued by the officers and employees referred to in paragraphs 1(b), 1(c) and 1(d) of this Order.

1(g) Tax Fraud Investigative Aides, GS-5 and above, who are assigned to the district Criminal Investigation activity may serve any summons issued by the officers and employees referred to in Paragraphs 1(b) and 1(c) of this Order.

2. Each of the officers and employees referred to in paragraphs 1(b), 1(c) and 1(d) of this Order authorized to issue summonses, is delegated the authority under 26 CFR part 301, 7602-1(b) to designate any other officer or employee of the Internal Revenue Service referred to in paragraph 4(b) of this Order, as the individual before whom a person summoned pursuant to Section 7602 of the Internal Revenue Code shall appear. Any such other officer or employee of the Internal Revenue Service when so designated in a summons is authorized to take testimony under oath of the person summoned and to receive and examine books, papers, records or other data produced in compliance with the summons.

3. Internal Security Inspectors are delegated the authority under 26 CFR 301.7603-1 to serve summonses issued in accordance with this Order by any of the officers and employees of the Inspection Service referred to in paragraphs 1(b)(1) and 1(c)(1) of this Order even though Internal Security Inspectors do not have the authority to issue summonses.

4(a) The authorities granted to the Commissioner of Internal Revenue by 26 CFR 301.7602-1(a), and 301.7605-1(a) to examine books, papers, records or other data, to take testimony under oath and to set the time and place of examination are delegated to the officers and employees of the Internal Revenue Service specified in paragraphs 4(b) and 4(c) of this Order and subject to the limitations stated in paragraphs 4(c) and 6 of this Order.

4(b) General Designations

(1) Inspection: Director, Internal Security Division; Director, Internal Audit Division; Regional Inspectors; Internal Auditors; Management Auditors; Internal Security Inspectors; Investigators (Internal Security); and Internal Security Assistants.

(2) District Criminal Investigation: Assistant Chief of Division; and Special Agents.

(3) International: Deputy Assistant Commissioner (International), Special Agents; Case Managers; Group Managers, Internal Revenue Agents; Estate Tax Attorneys; Estate Tax Law Clerks; Estate Tax Examiners; Revenue Service and Assistant Revenue Service Representatives; Tax Auditors; Revenue Officers; and Tax Examiners whose duties include contacting taxpayers in person.

(4) District Collection Activity: Assistant Chiefs of Division; Revenue Officers; and Tax Examiners whose duties include contacting taxpayers in person.

(5) District Examination: Internal Revenue Agents; Tax Auditors; Estate Tax Attorneys; Estate Tax Law Clerks; and Estate Tax Examiners.

(6) District Employee Plans and Exempt Organization: Internal Revenue Agents; Tax Law Specialists; and Tax Auditors.

(7) Service Center/Austin Compliance Center: Revenue Agents; Tax Auditors; Tax Examiners in the correspondence examination function; and Special Agents.

4(c) District Directors, Service Center Directors, Austin Compliance Center Director, Regional Inspectors, and the Chief of Investigation Branch, Internal Security Division, may redelegate the authority under 4(a) of this Order to student trainees (Revenue Officer), (Revenue Agent), (Internal Audit), and (Internal Security), and Examination Aides, and Tax Fraud Investigative Aides, provided that each student trainee or aide shall exercise said authority only under the appropriate supervision of a Revenue Officer, Tax Auditor, Revenue Agent, Special Agent, Internal Auditor, or Internal Security Inspector, as applicable.

5. With the exceptions noted below, the officers and employees of the Internal Revenue Service referred to in paragraphs 1(b), 1(c), 1(d), and 4(b) and 4(c) of this Order are designated to administer oaths and affirmations and to certify to such papers as may be necessary under the internal revenue laws and regulations except that the authority to certify shall not be construed as applying to those papers or documents the certification of which is authorized by separate order or directive. This authority is granted to the Commissioner of Internal Revenue by 26 CFR 301.7622-1.

6. Tax Examiners, referred to in paragraph 4(b)4 of this Order, and Tax Fraud Investigative Aides, GS-5 and above, referred to in paragraph 4(c), are not designated to administer oaths or to perform the other functions mentioned in these paragraphs, except as follows. Tax Examiners, and Tax Fraud Investigative Aides, GS-5 and above, are authorized to certify the method and manner of giving notice when performing the functions and duties contained in paragraphs 1(f) and 1(g), respectively.

7. The authority delegated herein may not be redelegated except as provided in paragraph 4(c).

8. Delegation Order No. 4 (Rev. 19), effective January 26, 1989, is superseded.

Dated: February 15, 1990.

Approved:

Charles H. Brennen,
Deputy Commissioner
(Operations).

(Filed by the Office of the Federal Register on March 1, 1990, 8:45 a.m., and published in the issue of the Federal Register for March 2, 1990, 55 F.R. 7626)

Delegation Order No. 143 (Rev. 4)

Effective April 4, 1990

AGENCY: Internal Revenue Service, Treasury.

ACTION: Delegation of authority.

SUMMARY: Delegation Order No. 143 (Rev. 4) redelegates authority to perform certain functions related to the enforcement of 31 CFR 103 (Bank Secrecy Act Regulations) that was delegated to the Commissioner by Treasury Directive 15-41, dated December 8, 1987, and procedures approved by Assistant Secretary of the Treasury (Enforcement) to Assistant Commissioner (Criminal Investigation); District Directors and Assistants; Special Assistant for Enforcement, Detroit Computing Center, and Chiefs, Criminal Investigation Division. In Assistant Commissioner (International) this authority will be exercised as it relates to tax treaty partners or tax executive agreement.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

Authority To Perform Certain Functions To Enforce 31 CFR 103 (Bank Secrecy Act Regulations)

1. The authority vested in the Commissioner of Internal Revenue by 31 CFR 103.46(a)(8), to initiate investigations of financial institutions other than banks and brokers or dealers in securities as referenced in 31 CFR 103.46(a)(1) through 103.46(a)(6) for possible criminal violations of 31 CFR Part 103 (except 31 CFR 103.23 and 103.48), is hereby delegated pursuant to 31 CFR 103.46(a)(8) and 26 CFR 301.7701-9(c) to the Director, Office of Enforcement, and to the Chiefs, Criminal Investigation Division (District Directors in streamlined districts) and Chief, Criminal Investigation Division, Office of Taxpayer Service and Compliance, Assistant Commissioner (International). This authority may not be redelegated.

2. The authority vested in the Commissioner by Treasury Directive 15-41, to initiate investigations of banks and brokers or dealers in securities referenced in 31 CFR 103.46(a)(1) through 103.46(a)(6) for possible criminal violations of 31 CFR part 103 (except 31 CFR 103.23 and 103.48), is hereby delegated to the Assistant Commissioner (Criminal Investigation) pursuant to Treasury Order 150.10 and Treasury Directive 15-41, and Memorandum of Understanding approved September 6, 1985, and Clarification of Memorandum approved January 29, 1986, between the Assistant Secretary (Enforcement and Operations) and the Commissioner, Internal Revenue Service, and 26 CFR 301.7701-9(c). This authority may not be redelegated.

3. The authority vested in the Commissioner by Treasury Directive 15-41, to perform certain functions related to the enforcement of 31 CFR part 103, is hereby delegated pursuant to Treasury Order 150-10 and Treasury Directive 15-41, and Memorandum of Understanding approved September 6, 1985, between the Assistant Secretary (Enforcement and Operations) and the Commissioner, Internal Revenue Service and 26 CFR 301.7701-9(c) as follows:

(a) The Director, Detroit Computing Center, is delegated the authority to:

(1) Grant exemptions from the reporting requirements contained in 31 CFR 103.22(a);

(2) Issue requests for lists of financial institution customers whose currency transactions have been exempted from the reporting requirement in 31 CFR 103.22; and

(3) Direct banks to file currency reports as prescribed in 31 CFR 103.22(a)(1) with respect to customers whose transactions had been previously exempted.

(b) The Assistant Commissioner (Examination) is delegated the civil enforcement authority for the compliance aspects of 31 CFR 103.22(b) (c), (d), (e), and (f) regarding exemptions.

(c) The District Directors and the Assistant Commissioner (International) are delegated the authority to assure compliance with the requirements of 31 CFR part 103 by all banks not currently examined by Federal supervisory agencies for safety and soundness.

(d) The authority delegated in (a) above may be redelegated by the Director, Detroit Computing Center, but may not be further redelegated.

(e) The authority delegated in (b) above may be redelegated by the Assistant Commissioner (Examination) but may not be further redelegated.

(f) The authority delegated in (c) above may be redelegated by the District Directors and the Assistant Commissioner (International) but may not be further redelegated.

4. The authority vested in the Commissioner by 31 CFR 103.46(a)-(8) to assure compliance with the requirements of 31 CFR part 103 by those financial institutions not referenced in 31 CFR 103.46(a)(1) through 103.46(a)(6), is hereby delegated pursuant to 31 CFR 103.46(a)(8) and 26 CFR 301.7701-9(c) to the Assistant Commissioner (Examination) and to the Chiefs, Examination Division (District Directors in streamlined districts) and Chief, Examination Division, Office of Taxpayer Service and Compliance, Assistant Commissioner (International). This authority may be redelegated by the Assistant Commissioner (Examination) and the Chiefs, Examination Division (District Directors in streamlined districts), but may not be further redelegated.

5. The authority vested in the Commissioner by Treasury Directive 15-41, specifically to disseminate copies of the reports required by Department of the Treasury regulations (31 CFR part 103), issued to implement 31 U.S.C. 5319, is delegated to the officials listed below. The exercise of this authority is subject to the Dissemination Policies and Guidelines for the Release of Information Reported under the Provisions of the Bank Secrecy Act issued by the Assistant Secretary of the Treasury (Enforcement). This authority may not be redelegated.

a. Assistant Commissioner (Criminal Investigation),

b. District Directors and Assistants,

c. Special Assistant for Enforcement, Detroit Computing Center, and

d. Chiefs, Criminal Investigation Division. In Assistant Commissioner (International) this authority will be exercised as it relates to tax treaty partners or tax executive agreements.

6. Delegation Order No. 143 (Rev. 3), effective May 12, 1986, is superseded.

Dated: March 14, 1990.

Approved:

Charles H. Brennan,
Deputy Commissioner (Operations).

(Filed by the Office of the Federal Register on April 9, 1990, 8:45 a.m., and published in the issue of the Federal Register for April 10, 1990, 55 F.R. 13351)

Delegation Order No. 222 (Rev. 2) Effective March 20, 1990

AGENCY: Internal Revenue Service.

ACTION: Delegation of authority.

SUMMARY: The Assistant Commissioner (Criminal Investigation) and anyone acting for him/her is delegated authority to approve the making of application for court orders to monitor pagers and facsimile trans-

ceivers. The Chief, Criminal Investigation Division (District Directors in streamlined districts), the Director, Office of Enforcement (Criminal Investigation), National Office and anyone acting for these persons is delegated authority to approve the monitoring of tone-only pagers. The text of the delegation order appears below.

Authority to Approve the Use of Pen Registers and to Monitor Communications

Pursuant to the Authority vested in the Commissioner of Internal Revenue by Treasury Order 150-10 and 18 U.S.C. 2516, the authority to approve the use of pen registers; to authorize the application for issuance of a court order to monitor communications via display pagers, facsimile transceivers and tone and voice pagers (non-aural portion of the communications); and to approve the monitoring of communications via tone-only pagers is delegated as follows:

1. The Assistant Commissioner (Criminal Investigation) and anyone acting for him/her is authorized to approve the use of pen registers in the investigations involving felony violations within the jurisdiction of Criminal Investigation, wagering violations and for locating fugitives from justice charged with a violation who were the subject of an investigation by Criminal Investigation. Authorization by the Assistant Commissioner (Criminal Investigation) for the use of a pen register is contingent upon the obtaining of a court order prior to installation of the pen register. This authority may not be redelegated.

2. The Assistant Commissioner (Criminal Investigation) and anyone acting for him/her is authorized to approve the application for issuance of a court order to monitor communications via display pagers, facsimile transceivers and tone and voice pagers (non-aural portion of the communications). This authority may not be redelegated.

3. The Chief, Criminal Investigation Division (District Directors in streamlined districts), the Director, Office of Enforcement (Criminal Investigation), National Office and anyone acting for these persons may authorize the monitoring of communications via tone-only pagers. This authority may not be redelegated.

4. Delegation Order No. 222, (Rev. 1), effective October 28, 1987, is superseded.

Dated: January 30, 1990.

Approved:

Charles H. Brennan,
Deputy Commissioner (Operations).

(Filed by the Office of the Federal Register on March 22, 1990, 8:45 a.m., and published in the issue of the Federal Register for March 23, 1990, 55 F.R. 10864)

Supplemental Notice on Four-Year Spread of Items From a Common Trust Fund's Short Taxable Year

Notice 90-1

This notice supplements the guidance issued in Notice 89-22, 1989-1 C.B. 652, concerning the reporting of items from a common trust fund's short taxable year as a result of the common trust fund being required to change to a calendar year. Because of the limited duration of the spread period provisions, this notice, together with Notice 89-22, constitutes the only published guidance that the Service intends to issue in this area.

The Service has received numerous comments from the public on Notice 89-22. In response to those comments, this notice modifies some of the provisions of Notice 89-22 in an attempt to make the rules more administratively feasible for taxpayers. This notice also clarifies other provisions of Notice 89-22. The following is an overview of the provisions of this notice.

The section entitled *DEEMED INCREASE IN PARTICIPANT'S INCOME AS DEFINED IN SECTION 643(b)*: (1) contains new provisions that allow any trust that is required to distribute all its income currently but that is subject to the provisions of section 661 of the Code, rather than section 651, to have a deemed increase in section 643(b) income; (2) clarifies that the deemed increase in section 643(b) income is only hypothetical; and (3) clarifies that the deemed increase in section 643(b) income is accelerated if there is an acceleration of the spread items.

The section entitled *CAUSES OF ACCELERATION* contains rules on whether the spread items are required to be accelerated: (1) if the participant's investment is transferred to another common trust fund; (2) if the participant is a grantor trust; and (3) if the income beneficiary of the participant changes during the spread period.

The section entitled *METHODS FOR DETERMINING AMOUNT WITHDRAWN* contains two optional methods that can be used in lieu of the valuation method provided in Notice 89-22 to determine whether the participant has withdrawn a sufficient amount of its investment in the common trust fund to require an acceleration of the spread items.

BACKGROUND

Section 1008(e)(5)(A) of the Technical and Miscellaneous Revenue Act of 1988 ("the Act") added section 584(h) to the Internal Revenue Code. Section 584(h) provides that all common trust funds are required to use the calendar year. This provision is effective for taxable years beginning after December 31, 1987. As a result of this requirement, common trust funds that previously used a fiscal year had short taxable years in 1988. To prevent any participant in a common trust fund ("participant") from having to include income from two taxable years of the common trust fund in its income for 1988, a spread period of four years is provided for the income from the short taxable year.

Section 1008(e)(5)(B) of the Act provides that for purposes of section 806(e)(2) of the Tax Reform Act of 1986 (the four-year spread provisions for partners), a participant shall be treated in the same manner as a partner, except that a partner's election to include all of the income from the short taxable year in the year of change is not available to a participant. Section 806(e)(2), as applied to common trust funds, provides that a participant must spread income in excess of expenses attributable to the common trust fund's short taxable year ratably over the participant's first four taxable years with or within which the common trust fund's short taxable year ends.

DEEMED INCREASE IN PARTICIPANT'S INCOME AS DEFINED IN SECTION 643(b)

Notice 89-22 provides that, for purposes of sections 651(a) and 652(a)

of the Code, the amount of income required to be distributed currently shall be deemed to be increased, in each year of the spread period, by one-fourth of the spread amount that is includible in distributable net income under section 643(a). This provision in effect deems an increase for a simple trust in the amount of the trust's income as defined in section 643(b) during each year of the spread period. Inadvertently, no comparable provision was made for a trust that is required by its terms to distribute all of its income currently but that is subject to the provisions of section 661.

This notice corrects this oversight for any trust that is required by its terms to distribute all of its income currently but is subject to the provisions of section 661. Thus, for purposes of sections 661(a)(1) and 662(a)(1), the amount of income required to be distributed currently for such a trust shall be deemed to be increased, in each of the four years in the spread period, by the one-fourth of the spread amount that is includible in the trust's distributable net income. If such a trust filed its return for 1988 without providing for a deemed increase in the participant's income as defined in section 643(b), that trust has the option to file the appropriate amended returns for 1988 to take advantage of this deemed increase.

The deemed increase in a participant's income as defined in section 643(b) of the Code, if available, is solely for purposes of determining the amounts deductible by the participant under section 651(a) or section 661(a)(1) of the Code and the corresponding amounts includible in the beneficiaries' income under section 652(a) or section 662(a)(1). The amount of the increase is only hypothetical and does not increase the actual amount required to be distributed currently.

If during the spread period a participant that is eligible for the deemed increase is required to accelerate the reporting of all or a portion of the remaining spread items, the amount of the deemed increase in the participant's income as defined in section 643(b) of the Code is correspondingly accelerated.

CAUSES OF ACCELERATION

Participant Terminating or Withdrawing from Common Trust Fund

Notice 89-22 provides for the acceleration of the remaining spread items if a participant terminates or withdraws completely from the common trust fund prior to the expiration of the four-year spread period. In that situation, the participant must include all the amounts that would have been included in subsequent taxable years on account of the spread in the taxable year in which the participant terminates or withdraws from the common trust fund.

In response to taxpayers' inquiries, this notice clarifies the year for acceleration if a participant terminates upon the occurrence of an event that happens in one year but the participant does not actually wind up until the following year. In such a situation, the participant must take into account the balance of the spread items in the year the terminating event occurs.

Notice 89-22 provides that if a participant completely, or in certain circumstances partially, withdraws from a common trust fund, all or a portion of the remaining spread items are accelerated. This notice clarifies that the provisions requiring acceleration is applicable to a complete or partial withdrawal from a common trust fund even if the withdrawn funds are reinvested in another common trust fund operated by the same bank. However, a participant is not required to accelerate the spread items when the participant's interest in the common trust fund is transferred as a result of a combination of two or more common trust funds or a division of a single common trust fund if the transfer to the surviving or divided common trust fund is not considered to be a withdrawal or admission under section 1.584-4(a) of the Income Tax Regulations.

Grantor Trusts

Notice 89-22 does not discuss the treatment of a participant that is a grantor trust. If the grantor is treated as the owner of all the trust under sections 671 through 677, the grantor is considered to be the owner of the trust assets for federal income tax purposes. See Rev. Rul. 85-13, 1985-1 C.B. 184. Thus, the grantor is treated as the participant in the common trust fund and is the party entitled to the four-year spread of items from the common trust fund's short taxable year. If during the spread period the trust becomes a nongrantor trust either because of the death of the grantor or for some other reason, the remaining spread items are accelerated. In the case of the grantor's death, the remaining spread items are includible in the grantor's gross income for the grantor's last taxable year, and in all other situations they are includible in the grantor's gross income for the year the trust becomes a nongrantor trust.

Change in Income Beneficiary

Notice 89-22 provides that a change in the beneficiary of a participant during the spread period will not cause an acceleration of the remaining spread items. This notice reaffirms that position with respect to: (1) any trust that is not required by its terms to distribute all of its income currently; and (2) any trust that is required by its terms to distribute all of its income currently if there was a change in the income beneficiary of that trust in 1988.

This notice contains special rules for any trust that is required by its terms to distribute all of its income currently and that has a change in income beneficiary during the spread period but after 1988. These special rules are based on the assumption that the income beneficiary of the participant during the common trust fund's short taxable year in 1988 should be required to include in income all the spread items that would be includible in distributable net income under section 643(a) of the Code. Therefore, if the income beneficiary of the participant during 1988 ceases to be an income beneficiary of the participant during 1989 or 1990, the participant is required to accelerate the remaining spread items that would be includible in distributable net income. If the income beneficiary is alive and if certain procedures are followed, the income beneficiary will be entitled to continue to spread those items. Otherwise, the entire accelerated amount is includible in the beneficiary's gross income.

Tax Treatment for Participant

If the person who was entitled to receive all the income within the meaning of section 643(b) of the Code from the participant during the calendar year 1988 ceases to be a beneficiary of the participant during any year of the spread period, the participant, in the year the beneficiary changes, shall take into account, in addition to the ratable amount for the year, all the remaining spread items that would be includible in distributable net income under section 643(a) and that would otherwise remain unaccounted for at the end of the year. If there was more than one income beneficiary of the participant during 1988, the amount accelerated upon a change in any of those beneficiaries will be a portion of the remaining spread items that would be includible in distributable net income. The portion required to be accelerated bears the same relationship to the remaining spread items as the amount of income actually distributed in 1988 to the income beneficiary who has changed bears to the total income actually distributed in 1988 to all the income beneficiaries.

The deemed increase in income as defined in section 643(b) is correspondingly accelerated upon the acceleration of the spread items. Thus, the participant includes the accelerated amount in its deduction under section 651(a) or section 661(a)(1).

If the participant has items from the common trust fund's short taxable year that would not be includible in distributable net income, such as capital gains, the participant shall continue to spread those items ratably over the balance of the spread period.

Tax Treatment for Income Beneficiary

If the change in beneficiary was caused by the death of the beneficiary, the accelerated amount must be included in gross income on the beneficiary's final return. If the beneficiary is alive, the beneficiary must include the accelerated amount in the beneficiary's gross income for the year the beneficiary changed, unless the trustee of the participant and the beneficiary follow the procedures outlined below. If the trustee and the beneficiary follow these procedures, the beneficiary will be entitled to include the accelerated amount in gross income in the same manner that the beneficiary would have included it in income if the beneficiary were still a beneficiary of the participant during the entire spread period.

Procedures to Continue the Spread

In order for the beneficiary to be able to continue the spread, the trustee must provide the beneficiary a written statement attached to the Schedule K-1, Beneficiary's Share of Income, Deductions, Credits, Etc., that is issued to the beneficiary for the year in which such beneficiary ceased to be a beneficiary of the participant. That written statement must contain the following information:

(1) the beneficiary must either include the entire amount attributable to the accelerated spread items in income for the year the beneficiary ceased being a beneficiary of the trust or elect to take the accelerated spread amount into income ratably over the number of years remaining in the spread period beginning with the year the beneficiary changed;

(2) the amount accelerated and the number of years over which that amount must be taken into account, if the beneficiary elects to include the accelerated amount in income over the remaining spread period;

(3) if the beneficiary elects to include the accelerated amount in income over the remaining spread period and dies during the spread period, the balance of the accelerated items must be included in the beneficiary's final income tax return;

(4) the beneficiary makes the election to continue to spread the remaining items under these procedures by writing at the top of the beneficiary's Schedule E, Supplemental Income and Loss, the statement "Electing spread procedures under Notice 90-1"; and

(5) by writing this statement on Schedule E, the beneficiary signifies the beneficiary's agreement to abide by all the special spread procedures described in the written statement.

If the beneficiary receives a statement attached to the Schedule K-1 that contains the above-described information, the beneficiary can elect to continue to spread the accelerated amount. The beneficiary makes the election to continue to spread the accelerated amount by writing at the top of the beneficiary's Schedule E, Supplemental Income and Loss, the statement "Electing spread procedures under Notice 90-1." By writing this statement on Schedule E, the beneficiary signifies the beneficiary's agreement to abide by all the special spread procedures outlined above.

Examples

The provisions set forth above may be illustrated by the following examples. In each example, assume that: (1) the common trust fund has not paid or incurred any affected expenses within the meaning of section 1.67-2T(i) of the Temporary Income Tax Regulations; (2) the common trust fund's short taxable year was September 1, 1988, through December 31, 1988; (3) for all years in question, the participant is a trust that receives $1,000 of ordinary taxable income from the common trust fund each month and is subject to the provisions of section 651 of the Code; and (4) there was no change in any of the income beneficiaries of the participant during 1988. The examples would also apply to any trust that is subject to the provisions of section 661 if under the terms of the trust all the income of the trust is required to be distributed currently.

Example (1). In 1988 A, as the only income beneficiary of the trust that year, received cash of $12,000. The trust's distributable net income under section 643(a) of the Code was $13,000 ($12,000 from the common trust fund's taxable year ending August 31, 1988, plus one-fourth of the $4,000 from the common trust fund's short taxable year). The trust was entitled to a deduction under section 651 for $13,000, and A was required to include in A's 1988 gross income $13,000 of ordinary taxable income under section 652.

In 1989 A receives $1,000 from the trust as the income beneficiary of the trust during January and dies on February 1, 1989. The trust continues with B as the income beneficiary. Because the income beneficiary of the trust during 1988 ceases to be an income beneficiary during 1989, the trust is required to take into account the remaining spread items that would be includible in the trust's distributable net income under section 643(a) and that otherwise would be

unaccounted for at the end of 1989. The trust's distributable net income for 1989 is $15,000 ($12,000 from the common trust fund's taxable year ending December 31, 1989, plus $1,000 representing the ratable spread amount for 1989, plus $2,000 representing the remaining spread items that would be includible in distributable net income and that would otherwise be unaccounted for at the end of 1989). The trust is entitled to a deduction under section 651 for $15,000.

B is required to include in B's 1989 gross income $11,000 of ordinary taxable income under section 652. This amount represents the trust's income from February through December that was distributed to B. The remaining $4,000 of ordinary taxable income is includible in gross income on A's final tax return under section 652. This amount represents the trust's income from January ($1,000), the ratable amount of the spread items for 1989 ($1,000), and the remaining spread items that would be includible in distributable net income and that would otherwise be unaccounted for at the end of 1989 ($2,000). If the trust had capital gains or losses from the common trust fund's short taxable year that would not be includible in the trust's distributable net income, the trust will continue to spread those items, in the absence of some other event that would cause acceleration of those items.

Example (2). The facts are the same as in Example (1), except A is alive when A ceases to be an income beneficiary of the trust. B and the trust have the same tax results as in Example (1). A is required to include in A's 1989 gross income $4,000 of ordinary taxable income under section 652, unless the trustee and A follow the special spread procedures described above. If the trustee furnishes the supplemental information attached to A's Schedule K-1, and if A makes the election described above, A is required to include $2,000 on A's 1989 return, $1,000 on A's 1990 return, and $1,000 on A's 1991 return.

Example (3). During 1988 A and B, as the income beneficiaries of the trust, each received cash distributions of $6,000. The trust's distributable net income for 1988 was $13,000 ($12,000 from the common trust fund's taxable year ending August 31, 1988, plus one-fourth of the $4,000 from the common trust fund's short taxable year). The trust was entitled to a deduction under section 651 for $13,000, and A and B were required to include in gross income a total of $13,000 of ordinary taxable income under section 652.

A and B each receive $500 representing one-half of the trust's income for January 1989. On February 1, 1989, A, who is alive, ceases to be an income beneficiary. B, as the sole income beneficiary of the trust, receives $11,000 from the trust during the balance of 1989.

A and B are treated as having each received a portion of the income earned by the trust from the common trust fund's short taxable year. That portion of the income from the common trust fund's short taxable year that each beneficiary is treated as having received has the same relationship to the total income from the common trust fund's short taxable year as the amount of income actually distributed to each beneficiary in 1988 bears to the total income actually distributed in 1988. In this case A and B each received $6,000 out of a total of $12,000 in income actually distributed by the trust in 1988. Thus, each is treated as having received one-half of the income earned by the trust from the common trust fund's short taxable year.

Because A is no longer a beneficiary of the trust, the trust is required to take into account in 1989 one-half of the spread items that would be includible in the trust's distributable net income and that would otherwise be unaccounted for at the end of 1989. The trust's distributable net income for 1989 is $14,000 ($12,000 from the common trust fund's taxable year ending December 31, 1989, plus $1,000 representing the ratable spread amount for 1989, plus $1,000 representing one-half of the remaining unreported spread items). The trust is entitled to a deduction under section 651 for $14,000.

For 1989, B is required to include in gross income under section 652 $12,000 ($500 from the January income, plus $11,000 from the February through December income, plus $500 from one-half of the ratable spread amount includible by the trust in 1989). A is required to include in gross income under section 652 $2,000 ($500 from the January income, plus $500 from one-half of the ratable spread amount for 1989, plus $1,000 from the acceleration of the one-half of the remaining unreported spread items). If the trustee and A follow the special procedures described above, A can elect to report $1,000 in 1989 and to report the $1,000 from the acceleration of the one-half of the remaining unreported spread items in two equal amounts of $500 in 1990 and 1991.

Example (4). The trustee is required to distribute all the income currently but can decide which beneficiaries are to receive the income each year. During 1988 the trustee distributed to A $12,000 representing all the income actually received by the trust during that year. The trust's distributable net income for 1988 was $13,000; the trust was entitled to a distribution deduction under section 651 for $13,000; and A was required to include $13,000 in income under section 652.

In 1989 the trustee distributes all the income equally between B and C. Although A did not receive any actual distributions during 1989, A is still a potential income beneficiary of the trust. Consequently, the trust is required to take into account in 1989 only the ratable amount of the spread items for that year and not any additional unreported amounts. The trust's distributable net income for 1989 is $13,000, and the trust is entitled to a deduction of $13,000 under section 651. B and C are each required to include $6,000 in gross income under section 652. Although A did not receive any actual distributions from the trust in 1989, A is deemed to have received the ratable amount of the spread items includible by the trust in its distributable net income for the year. Therefore, A is required to include $1,000 in A's gross income for 1989 under section 652.

METHODS FOR DETERMINING AMOUNT WITHDRAWN

Notice 89-22 provides that under certain circumstances the participant is required to accelerate all or a portion of the remaining spread amounts if the participant makes a partial withdrawal of its corpus investment in the common trust fund during the four-year spread period. A

fraction is used to determine whether an acceleration is required for the taxable year of the withdrawal. If the participant's corpus withdrawals are less than 1/3, there is no acceleration. If the participant's withdrawals are equal to or greater than 1/3 but less than 2/3, the participant must, in addition to the ratable amount for the year, take into account 50 percent of the spread items that would otherwise remain unaccounted for at the end of the year. This particular provision applies only once with respect to a participant's interest in a common trust fund. If the participant's withdrawals are equal to or greater than 2/3, the participant must take into account the entire balance of the spread items in that year.

The method used in Notice 89-22 to compute the fraction is based on the value of the participant's investment in the common trust fund. Specifically, the numerator of the fraction is the value of any investments withdrawn during the spread period but on or before the end of the taxable year minus the value of any additional investments contributed during the spread period but on or before the end of such taxable year. The denominator of the fraction is the value of the participant's investment in the common trust fund at the end of the taxable year plus the value of any investments withdrawn during the spread period but on or before the end of the taxable year minus the value of any additional investments contributed during the spread period but on or before the end of the taxable year. The values to be used in this fraction are the fair market value of the participant's investment in the common trust fund at the end of the taxable year and the fair market value of any withdrawals or contributions at the date of the withdrawal or contribution. Investments withdrawn or contributed during 1988 are used in the fraction only if they occurred during the common trust fund's short taxable year.

As an alternative to using the value of the participant's investment in the common trust fund to determine the fraction, the participant has the option of using the participant's unit investment or percentage interest in the common trust fund. If the participant reported a partial acceleration of the spread items on its 1988 return based on the method provided in Notice 89-22, the participant: (1) may file the appropriate amended returns for 1988 to change to a different method for the entire spread period; (2) may use a method different from the one used in 1988 to determine the need to accelerate the remaining spread items during the balance of the spread period; or (3) may continue to use the same method as the one used in 1988 to determine the need to accelerate the remaining spread items during the balance of the spread period. If the participant did not report a partial acceleration of the spread items on its 1988 return, the participant must use the same method to determine the need for acceleration during each year of the spread period.

Unit Method

If the participant uses the unit method to determine the fraction, the fraction used to determine whether an acceleration is required for the taxable year is based on units rather than value. The numerator of the fraction is the number of units that the participant withdrew during the spread period but on or before the end of the taxable year minus the number of additional units purchased during the spread period but on or before the end of the taxable year. The denominator of the fraction is the number of units the participant holds in the common trust fund at the end of the taxable year plus the number of units withdrawn during the spread period but on or before the end of the taxable year minus the number of additional units purchased during the spread period but on or before the end of the taxable year. Units withdrawn or purchased during 1988 are used in the fraction only if the transactions occurred during the common trust fund's short taxable year. If the common trust fund changes the way it computes its units during the spread period, appropriate adjustments must be made to the fraction.

Percentage Investment Method

The percentage investment method measures a participant's continuing investment in the common trust fund, while the fraction to determine the need for acceleration under Notice 89-22 is based on the participant's withdrawals of its investment in the common trust fund. If the participant uses the percentage investment method to determine the fraction, the participant must compute the complement of the fraction that shows the participant's continuing investment in the common trust fund. Thus, the participant must subtract the following fraction from the number 1. The numerator of the fraction is the participant's proportionate interest in the common trust fund at the end of the taxable year, and the denominator is the participant's proportionate interest in the common trust fund as of the last day of the common trust fund's short taxable year.

For example, if the participant's proportionate interest in the common trust fund at the end of the 1989 taxable year is 1 percent but the participant's proportionate interest in the common trust fund as of the last day of the common trust fund's short taxable year was 4 percent, then the fraction that shows the participant's continuing investment in the common trust fund is 1/4. To determine whether the participant has withdrawn a sufficient interest in the common trust fund to require acceleration of the spread items, the fraction must be subtracted from the number 1 (1 - 1/4 = 3/4). The complement of the fraction (3/4) is greater than 2/3 (the participant has withdrawn more than 2/3 of its investment in the common trust fund), and, therefore, the participant must take into account in 1989 the entire balance of the spread items.

PROCEDURAL INFORMATION

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Maintenance of Effort

Notice 90-2

PURPOSE

The purpose of this notice is to provide guidance to employers and

Medicare beneficiaries regarding the tax treatment and reporting requirements for refunds paid or benefits received under the Maintenance of Effort provision of the Medicare Catastrophic Coverage Act of 1988 (Pub. L. 100-360).

I. BACKGROUND

The Medicare Catastrophic Coverage Act of 1988 (the MCCA) was enacted on July 1, 1988. The MCCA provided benefits not previously available under Medicare and protected beneficiaries against costs associated with a catastrophic illness. The MCCA provided expanded Part A benefits effective January 1, 1989, and expanded Part B benefits effective January 1, 1990.

The expansion of Medicare coverage in 1989 placed certain Medicare beneficiaries in the position of receiving the same coverage under both their employer's health benefits plan and under the Medicare program. Because of this potential for duplicative health benefit coverage, Congress included the Maintenance of Effort provision in section 421 of the MCCA. This section required that if, as of July 1, 1988, an employer provided to an employee or retired former employee duplicative benefits (*i.e.*, employer provided benefits that would also be available to Medicare beneficiaries as a result of the MCCA) the employer must either (1) provide to the employee or retired former employee additional benefits that are at least equal in actuarial value to the duplicative benefits, (2) refund to the employee or retired former employee an amount of money equal in actuarial value to the duplicative benefits, or (3) provide a combination of additional benefits and refunds that total at least the actuarial value of the duplicative benefits.

On December 6, 1988, the Health Care Financing Administration (HCFA) published a notice (53 FR 49233 (1988)) that provided guidelines for employers to use in determining whether they offered any duplicative benefits to their employees or retired former employees and, if so, the actuarial value of such benefits. The HCFA notice provided that Maintenance of Effort refunds for 1989 must be made no later than December 31, 1989. On August 25, 1989, HCFA published an additional notice (54 FR 35395 (1989)) that further clarified the Maintenance of Effort provision.

Large portions of the MCCA were repealed by the Medicare Catastrophic Coverage Repeal Act of 1989 (Pub. L. 101-234). However, the Maintenance of Effort provision of section 421 was retained for calendar year 1989.

II. TAX TREATMENT OF BENEFITS AND REFUNDS

Under sections 105 and 106 of the Internal Revenue Code, medical coverage and benefits provided by an employer under an accident or health plan generally are excludable from the gross income of an employee or retired former employee. Therefore, if the employer elects to comply with section 421 of the MCCA by providing additional accident or health benefits, those benefits are excludable from gross income under sections 105 and 106 of the Code and are not wages for employment tax or income tax purposes.

If the employer elects to refund a portion of the value of the duplicative benefits, the amounts refunded are included in the gross income of the recipient under section 61 and are subject to federal income tax. The Service has determined, however, that income tax withholding is not required with respect to the Maintenance of Effort payments provided such payments are reported in a manner consistent with the requirements set forth in Part III of this notice. In addition, section 10202 of the Omnibus Budget Reconciliation Act of 1989 provides that the Maintenance of Effort payments do not constitute "wages" for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act, the Railroad Retirement Act or the Railroad Unemployment Repayment Tax and that such payments do not constitute "compensation" for purposes of the Railroad Unemployment Insurance Act. Therefore, no amounts should be withheld for taxes imposed by these Acts or provisions.

III. REPORTING REQUIREMENTS

Reporting Alternatives

Maintenance of Effort refund payments made to current employees must be reported on either Form W-2 or Form 1099-MISC. Maintenance of Effort refund payments made to employees who separated from employing during the year must be reported either on Form W-2 or on Form 1099-MISC or Form W-2P. Maintenance of Effort refund payments to retired former employees who have been separated from service for the entire year or to the beneficiaries of any former employees must be reported either on Form 1099-MISC or Form W-2P.

Reporting on Form W-2

Maintenance of Effort refund payments reported on Form W-2 must be reported as wages in Box 10. Employers should not include them as Social Security wages in Box 13. If the employer has already issued a Form W-2 to the recipient, a revised Form W-2 or a second Form W-2 reporting the Maintenance of Effort refund must be provided to the employee or retired former employee. In each case, the additional statement described below must be included with the Form W-2 issued to the recipient. When filing Forms W-2 with the Social Security Administration (SSA), regardless of whether the employer has issued one or more Forms W-2 to the recipient, the Maintenance of Effort payment may be included on the same Form W-2 reporting other wages for the year.

Reporting on Form W-2P

The Maintenance of Effort refund payment may be reported in Boxes 9 and 10 on a separate Form W-2P, Statement for Recipients of Annuities, Pensions, Retired Pay, or IRA Payments, or an acceptable substitute. Employers should not report Maintenance of Effort payments on the same Form W-2P on which they are reporting pension and other similar distributions. The Maintenance of Effort refund reporting forms must be transmitted to SSA using a separate transmittal document (Form W-3 or 6559, whichever applies). At the top of the transmittal document, enter the words "Maintenance of Effort Payments." The additional statement described below must be included with each Form W-2P (or acceptable substitute) issued to a recipient.

Reporting on Form 1099-MISC

Report in Box 6 (Medical and health care payments) on a separate Form 1099-MISC, Statement for Recipients of Miscellaneous Income or an acceptable substitute. The Maintenance of Effort refund reporting forms must be transmitted to IRS using a separate transmittal document (Form 1096 or 4804, whichever applies). At the top of the transmittal document, enter the words "Maintenance of Effort Payments." If you use this method a Form 1099-MISC must be filed and issued regardless of the amount of the payment. Thus, the usual $600 threshold does not apply.

Additional Statement

An employer paying a Maintenance of Effort refund must also furnish to the recipient an additional statement with the Form W-2, Form W-2P, Form 1099-MISC, or with the acceptable substitute reporting the refund. The additional statement must explain the nature of the payment and how the recipient must report the payment on his or her income tax return. The following is an example of an acceptable statement for this purpose:

SPECIAL EXPLANATION

The amounts reported on the enclosed Form [W-2, W-2P, or 1099-MISC] include a refund made to you of the part of the premium your employer paid for accident and health insurance coverage that was a duplication of your Medicare coverage. This refund was required by the federal Medicare Catastrophic Coverage Act, which has since been repealed for future years.

The refund is included in your gross income for federal income tax purposes, and it must be reported as "wages" on line 7 of Form 1040 or 1040A or on line 1 of Form 1040EZ.

This amount is not included in "wages" for purposes of withholding or paying FICA or FUTA taxes. [Appropriate employers may instead refer to the Railroad Retirement Tax Act, the Railroad Retirement Act or the Railroad Unemployment Repayment Tax and the Railroad Unemployment Insurance Act.]

IV. PROCEDURAL INFORMATION

This notice serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure. No inference should be drawn regarding any issue not specifically addressed in this notice.

Ceding Commissions—Change in Method of Accounting

Notice 90-3

This notice advises life insurance companies that, except as provided below, the Internal Revenue Service will not entertain an application on Form 3115, Application for Change in Accounting Method, filed pursuant to Rev. Proc. 84-74, 1984-2 C.B. 736, to change a life insurance company's method of accounting for the treatment of ceding commissions to comply with the Supreme Court decision in *Colonial American Life Insurance Company v. Commissioner*, Ct. D. 2045 [491 U.S.], 1989-2 C.B. 110, for a year of change beginning before January 1, 1991.

In Announcement 89-89, 1989-29 I.R.B. 36, the Service advised insurance companies that a revenue procedure will be issued that will apply to changes to the proper method of accounting for ceding commissions to comply with the Supreme Court decision in the *Colonial American* case. This revenue procedure will provide special procedures to permit an insurance company to change its method of accounting for ceding commissions for the tax year that includes June 15, 1989, including an appropriate extension of time to take any required steps. The revenue procedure will prescribe rules for determining the tax year of change as well as the appropriate adjustment period over which any adjustments required by section 481(a) of the Internal Revenue Code shall be taken into account. The forthcoming revenue procedure will provide the exclusive method for requesting these changes for tax years beginning before January 1, 1991. The revenue procedure will also provide separate guidance to life insurance companies that are under examination or otherwise described in section 4.01 of Rev. Proc. 84-74.

PROCEDURAL INFORMATION

This notice serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Weighted Average Interest Rate Update

Notice 90-4

Notice 88-73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of section 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 (OBRA 1987).

The notice also provides that an announcement will be published monthly to provide the weighted average and the permissible range for the plan years beginning each month. The following rates were determined for the plan years beginning in the months shown below.

Month	Year	Weighted Average	Permissible Range
December	89	8.59	7.73 to 9.45

Administrative Pronouncement

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extend as a revenue ruling or revenue procedure.

Extension of December 31, 1989 Deadline in Temp. Reg. 1.1503-2T(c)(4)(ii)

Notice 90-5

Section 1.1503-2T contains the temporary regulations pertaining to section 1503(d) of the Code. T.D. 8261, 1989-2 C.B. 220. Section 1.1503-2T(c)(4) provides transition relief to certain dual resident corporations and their affiliated groups that complete a qualified restructuring, as described

in section 1.1503-2T(c)-(4)(ii), on or before December 31, 1989.

This notice extends until December 31, 1990, the December 31, 1989, deadline for completing a qualified restructuring, as set forth in section 1.1503-2T(c)(4)(ii). All other provisions of section 1.1503-2T remain unchanged.

This document serves as an "administrative pronouncement" as that term is used in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

EFFECT ON OTHER DOCUMENTS

Section 1.1503-2T(c)(4)(ii) is modified.

Meaning of "Binding Contract" in Legislative Transitional Rules of the 1989 Act

Notice 90-6

Several amendments made by the Revenue Reconciliation Act of 1989 (the "1989 Act") do not apply to transactions for which "binding contracts" were in effect as of specified dates. This Notice provides guidance concerning the interpretation of "binding contract" transitional rules under the 1989 Act.

It is often difficult to determine when a contract becomes "binding" under applicable state, local, or other law. The existence of an unfulfilled condition in a contract may create uncertainty as to whether the contract is binding on a party to the contract, even in situations where failure of the party to perform the contract would be reasonably likely to subject the party to significant damages or another significant remedy. To alleviate this uncertainty, the Internal Revenue Service, in interpreting the 1989 Act, will not contend that a written contract duly executed by authorized individuals prior to the effective date of a particular provision in such Act is not binding solely because, on the effective date,

(i) it is subject to a condition outside the control of the parties (including, for example, regulatory agency approval);

(ii) insubstantial contractual terms remain to be negotiated by the parties; or

(iii) it is subject to approval by the board of directors of a corporate party where, prior to the effective date, the board has authorized or been apprised of the status of negotiations and formal board approval occurs reasonably promptly following execution of the written contract without further change to the agreement (except for insubstantial contractual terms).

This Notice serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure. *See* Rev. Rul. 87-138, 1987-2 C.B. 287.

Interest Exclusion for Qualified United States Savings Bonds Used for Higher Education Expenses[1]

Notice 90-7

This notice provides guidance to taxpayers who, beginning January 1, 1990, may purchase series EE United States savings bonds and exclude all or a portion of the interest on the bonds if the bond proceeds are used to pay qualified higher education expenses at eligible educational institutions. This interest exclusion is provided in section 135 of the Internal Revenue Code. Section 135 was added by section 6009 of the Technical and Miscellaneous Revenue Act of 1988.

Qualified United States Savings Bonds. To be eligible for the exclusion, the bonds must be series EE United States savings bonds issued after December 31, 1989. The bonds must be issued either in the name of the taxpayer (sole owner) or in the names of the taxpayer and the taxpayer's spouse (co-owners). The taxpayer must be at least 24 years old before the date the bonds are issued. The date the bonds are issued may precede the date the bonds are purchased because bonds are issued as of the first day of the month in which they are purchased. A taxpayer who purchases a qualified bond may designate any individual (including a child) as a beneficiary of the bond (payable on death).

Qualified Higher Education Expenses. Qualified higher education expenses are limited to tuition and required fees at eligible educational institutions. The amount of qualified higher education expenses must be reduced by amounts received as scholarships, fellowships, veteran's benefits, or other tax-exempt educational benefits. Expenses with respect to any course or other education involving sports, games, or hobbies, other than as part of a degree or certificate granting program, are not qualified higher education expenses. Eligible educational institutions include most public and nonprofit higher educational and post-secondary educational institutions eligible for federal assistance under the Higher Education Act of 1965 and the Carl D. Perkins Vocational Education Act.

Amount Excludable. The amount of interest on qualified United States savings bonds excludable under section 135 of the Code is limited by the amount of redemption proceeds (interest and principal) used to pay qualified higher education expenses during the same tax year as the redemption. If the amount of the qualified United States savings bond redemption proceeds exceeds the amount of the qualified higher education expenses paid in the tax year of redemption, the amount of excludable interest will be limited. For example, if two-thirds of the total bond redemption proceeds are used to pay qualified higher education expenses during the same tax year as the redemption, only two-thirds of the interest portion of the qualified United States savings bonds redemption proceeds is excludable.

In addition, the interest exclusion is phased out for joint filers with modified adjusted gross incomes between $60,000 and $90,000. Married individuals need to file joint returns to claim any interest exclusion. For single filers and heads of households, the phase-out range is between $40,000 and $55,000. After 1990, these limits will be indexed for inflation and then rounded to the nearest multiple of $50.00. Modified adjusted gross income is adjusted gross income modi-

[1] Also released as News Release IR-90-2, dated January 2, 1990.

fied by adding back certain exclusions for income from foreign sources, certain United States possessions, and Puerto Rico, and after taking into account taxable social security benefits, the IRA deduction, and the passive activity loss limitation.

Recordkeeping. Taxpayers may use Form 8818, Optional Form To Record Redemption of College Savings Bonds, to maintain records on redeemed bonds that are necessary to substantiate this interest exclusion. Form 8818 will be available in I.R.S. offices in January 1990.

PROCEDURAL INFORMATION

This notice serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or a revenue procedure.

Ozone-Depleting Chemicals Tax

Notice 90-8

This Notice informs the public of the rules relating to the tax on chemicals that deplete the ozone layer and on imported products containing such chemicals. These rules reflect amendments made by section 7506 of the Revenue Reconciliation Act of 1989 (Act) to the Internal Revenue Code (Code). Section 7506 of the Act added sections 4681 and 4682 (relating to the tax on ozone-depleting chemicals) to the Code. The substance of these rules will be issued as temporary regulations at a later date. The initial Imported Products Table referred to in section IV(f)(4)(i) of this Notice will be issued as a separate Notice. The exemption certificates referred to in section III(d) of this Notice will be set forth in the temporary regulations and not in either Notice. These rules are effective on January 1, 1990.

SECTION I

GENERAL INFORMATION ON THE TAXES IMPOSED WITH RESPECT TO OZONE-DEPLETING CHEMICALS

(a) *Taxes imposed.* Sections 4681 and 4682 of the Code impose the following taxes with respect to ozone-depleting chemicals:

(1) *Tax on ozone-depleting chemicals.* Section 4681(a)(1) of the Code imposes a tax on ozone-depleting chemicals that are sold or used by the manufacturer or importer thereof. Except as provided in section II of this Notice (relating to rigid foam insulation, feedstock use, and halons), the amount of the tax is equal to the product of—

(i) The weight (in pounds) of the chemical;

(ii) The base tax amount (determined under section 4681(b)(1)(B) or (C)) of the Code for the calendar year in which the sale or use occurs; and

(iii) The ozone-depletion factor (determined under section 4682(b) of the Code) for the chemical.

(2) *Tax on imported taxable products.* Section 4681(a)(2) of the Code imposes a tax on imported taxable products that are sold or used by the importer thereof. Except as provided in section IV of this Notice, the amount of the tax is determined by reference to the weight of the ozone-depleting chemicals used as materials in the manufacture of the imported taxable product and is equal to the tax that would have been imposed on the chemicals under section 4681(a)(1) of the Code if the chemicals had been sold in the United States on the date of the sale or use of the imported product.

(3) *Floor stocks tax.*

(i) *Imposition of tax.* Section 4682(h) of the Code imposes a floor stocks tax on ozone-depleting chemicals that—

(A) Are held by any person (other than the manufacturer or importer of the chemical) on a date specified in paragraph (a)(3)(ii) of this section; and

(B) Are held on such date for sale or for use in further manufacture.

(ii) *Dates on which tax imposed.* The floor stocks tax on ozone-depleting chemicals is imposed on January 1 of 1990, 1991, 1992, and 1993.

(iii) *Amount of tax.* Except as provided in section V of this Notice, the amount of the floor stocks tax on an ozone-depleting chemical is equal to the excess of—

(A) The tax that would be imposed on the chemical under section 4681(a)(1) of the Code if the sale or use of the chemical by the manufacturer or importer had occurred on the date the tax is imposed (the tentative tax amount), over

(B) The sum of the taxes previously imposed on the chemical under sections 4681 and 4682 (zero for the floor stocks tax imposed on January 1, 1990).

(b) *Cross-references.*

(1) *Tax on ozone-depleting chemicals.* Additional rules relating to the tax on ozone-depleting chemicals are contained in sections II and III of this Notice.

(2) *Tax on imported products.* Additional rules relating to the tax on imported taxable products are contained in section IV of this Notice.

(3) *Floor stocks tax.* Additional rules relating to the floor stocks tax are contained in section V of this Notice.

(c) *Definitions of general application.* The following definitions set forth the meaning of certain terms for purposes of the regulations under sections 4681 and 4682 of the Code:

(1) *Ozone-depleting chemical.* The term "ozone-depleting chemical" means any chemical listed in section 4682(a)(2) of the Code.

(2) *United States.* Section 4682(e)(2) of the Code defines the term "United States".

(i) *In general.* The term "United States" means the 50 States, the District of Columbia, the Commonwealth of Puerto Rico, any possession of the United States, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands.

(ii) *Continental shelf areas and foreign trade zones.* The term "United States" includes—

(A) Submarine seabed and subsoil that would be treated as part of the United States (as defined in paragraph (c)(2)(i) of this section) under the principles of section 638 of the Code relating to continental shelf areas; and

(B) Foreign trade zones of the United States.

(3) *Manufacture; manufacturer.* The term "manufacture" when used with respect to any chemical or product includes its production, and the term "manufacturer" includes a producer.

(4) *Importer.*

(i) *In general.* The term "importer" means the person who enters (or should have entered) an ozone-depleting chemical or imported taxable product into the United States for consumption, use, or warehousing.

(ii) *Entry into United States.* An ozone-depleting chemical or imported taxable product is entered into the United States when an entry summary (Customs Form 7501) is filed with the appropriate customs officer, in proper form, with estimated duties attached.

(iii) *Entry summary filed by principal.* Except as provided in paragraph (c)(4)(iv) of this section, the person entering the chemical or product is the person who files the entry summary with respect to the chemical or product.

(iv) *Entry summary filed by agent.* If the person filing the entry summary is filing as an agent for another person (for example, the person filing the entry summary is a customs broker engaged by the owner), the person entering the chemical or product is the principal for whom the agent is acting.

(5) *Sale.* The term "sale" means the transfer of title or of substantial incidents of ownership (whether or not delivery to, or payment by, the purchaser has been made) for consideration which may include money, services, or other such chemicals or products. The determination as to the time a sale occurs shall be made under applicable local law.

(d) *Effective date.* Except as otherwise provided in section V of this Notice and paragraph (a)(3) of this section (relating to the floor stocks tax), the regulations under sections 4681 and 4682 of the Code will apply to—

(1) Ozone-depleting chemicals that the manufacturer or importer thereof sells or uses after December 31, 1989; and

(2) Imported taxable products that the importer thereof sells or uses after December 31, 1989.

SECTION II

OZONE-DEPLETING CHEMICALS

(a) *In general.* This section provides rules for identifying ozone-depleting chemicals that are subject to tax under section 4681(a)(1) of the Code (taxable ozone-depleting chemicals). See section I(a)(1) and (c) of this Notice for general rules and definitions relating to the tax on ozone-depleting chemicals.

(b) *Taxable ozone-depleting chemicals.*

(1) *In general.* Except as provided in paragraphs (c) through (g) of this section, a chemical is a taxable ozone-depleting chemical if the chemical—

(i) Is an ozone-depleting chemical (within the meaning of section I(c)(1) of this Notice) at the time of its sale or use by the manufacturer or importer of the chemical; and

(ii) Was manufactured in the United States or entered into the United States for consumption, use, or warehousing.

(2) *Taxable event.*

(i) *In general.* The tax on an ozone-depleting chemical is imposed when the chemical is sold or used by the manufacturer or importer of the chemical. The loss or destruction of a chemical is treated as a use for this purpose.

(ii) *Mixtures.* Except as provided in paragraph (b)(2)(iii) of this section, the creation of a mixture containing two or more chemicals is treated as a use of the ozone-depleting chemicals contained in the mixture. Thus, except as provided in paragraph (b)(2)(iii) of this section—

(A) The tax on the ozone-depleting chemicals contained in mixtures created after December 31, 1989, is imposed when the mixture is created and not on any subsequent sale or use of the mixture; and

(B) No tax is imposed under section 4681 of the Code on the ozone-depleting chemicals contained in mixtures created before January 1, 1990.

(iii) *Election to treat mixtures as ozone-depleting chemicals.*

(A) *In general.* A manufacturer or importer may elect to treat the sale or use of mixtures containing ozone-depleting chemicals as the first sale or use of the ozone-depleting chemicals contained in the mixtures. If an election under this paragraph (b)(2)(iii) applies to a mixture sold or used after December 31, 1989 (including any such mixture created before January 1, 1990), the tax on the ozone-depleting chemicals contained in the mixture is imposed on the date of such sale or use.

(B) *Applicability of election.* An election under this paragraph (b)(2)(iii) applies to all mixtures created by the manufacturer or importer.

(C) *Form of election, etc.* An election under this paragraph (b)(2)(iii) is made on Form 6627, Environmental Taxes, for the first calendar quarter beginning after December 31, 1989. The election may be revoked only with the consent of the Commissioner.

(c) *Rigid foam insulation.*

(1) *Phase-in of tax.*

(i) *In general.* The amount of tax imposed on an ozone-depleting chemical is determined under section 4682(g) of the Code if the manufacturer or importer of the chemical—

(A) Uses the chemical during 1990, 1991, 1992, or 1993 in the manufacture of rigid foam insulation; or

(B) Sells the chemical in a qualifying sale (as defined in section III of this Notice) during 1990, 1991, 1992, or 1993.

(ii) *Excess payments.* Under section 4682(g)(3) of the Code, a credit against income tax or a refund is allowed to a person if—

(A) The person uses an ozone-depleting chemical during 1990, 1991, 1992, or 1993 in the manufacture of rigid foam insulation; and

(B) The amount of any tax imposed on the chemical under section 4681 or 4682 of the Code was not determined under section 4682(g) of the Code.

(2) *Definition.*

(i) *In general.* The term "rigid foam" means any closed cell polymeric foam (whether or not rigid) in which chlorofluorocarbons are used to fill voids within the polymer. The term "rigid foam insulation" means any rigid foam that is designed for use as thermal insulation in buildings, equipment, appliances, transportation, tanks, or vessels, or on pipes.

(ii) *Rigid foam products.*

(A) *Composition.* Rigid foam includes extruded polystyrene foam, polyisocyanurate foam, spray and pour-in-place polyurethane foam, polyethylene foam, phenolic foam, and any other product that the Commissioner identifies as rigid foam in a pronouncement of general applicability.

(B) *Form.* Rigid foam includes any product identified under paragraph (c)(2)(ii)(A) of this section whether in the form of a board, sheet, backer rod, or wrapping, or in a form applied by spraying, pouring, or frothing.

(3) *Use in manufacture.* An ozone-depleting chemical is used in the manufacture of rigid foam insulation if it is incorporated into such insulation or is expended as a propellant or otherwise in the manufacture or application of such insulation.

(4) *Qualifying sale.* A sale of ozone-depleting chemicals is a qualifying sale if the certification requirements of section III(b)(1) of this Notice are satisfied with respect to such sale.

(d) *Phase-in of tax on halons.* The amount of tax imposed on halon-1211, halon-1301, or halon-2402 is determined under section 4682(g) of the Code if the manufacturer or importer of the chemical sells or uses the chemical during 1990, 1991, 1992, or 1993.

(e) *Feedstocks.*

(1) *Exemption from tax.*

(i) *In general.* No tax is imposed on an ozone-depleting chemical if the manufacturer or importer of the chemical—

(A) Uses the chemical as a feedstock in the manufacture of another chemical; or

(B) Sells the chemical in a qualifying sale (as defined in section III of this Notice) for use as a feedstock.

(ii) *Excess payments.* Under section 4682(d)(2) of the Code, a credit or refund is allowed to a person if—

(A) The person uses an ozone-depleting chemical as a feedstock; and

(B) The amount of any tax imposed on the chemical under section 4681 or 4682 of the Code was not determined under section 4682(d)(2) of the Code.

(2) *Use as a feedstock.* An ozone-depleting chemical is used as a feedstock only if the chemical is entirely consumed in the manufacture of another chemical (within the meaning of 40 CFR 82.3(s) (relating to the definition of production for purposes of Environmental Protection Agency regulations on the protection of atmospheric ozone)). Thus, the transformation of an ozone-depleting chemical into one or more new compounds (such as the transformation of CFC-113 into chlorotrifluoroethylene (CTFE or 1113) or of CFC-113 into CFC-115 and CFC-116)) is treated as use as a feedstock. On the other hand, the ozone-depleting chemicals used in a mixture (including an azeotrope such as R-500 or R-502) are not used as a feedstock.

(3) *Qualifying sale.* A sale of ozone-depleting chemicals is a qualifying sale if the certification requirements of section III(b)(2) of this Notice are satisfied with respect to such sale.

SECTION III

QUALIFYING SALES

(a) *In general.*

(1) *Special rules applicable to certain sales.* Special rules apply to sales of ozone-depleting chemicals in the following cases:

(i) Under section 4682(g) of the Code and sections II(c) and V(e)(2)(i) of this Notice (relating to ozone-depleting chemicals used in the manufacture of rigid foam insulation), ozone-depleting chemicals sold in qualifying sales are not taxed in 1990 and are taxed at a reduced rate in 1991, 1992, and 1993.

(ii) Under section 4682(d)(2) of the Code and sections II(e) and V(e)(2)(ii) of this Notice (relating to ozone-depleting chemicals used as feedstocks), ozone-depleting chemicals sold in qualifying sales are not taxed.

(2) *Registration not required.* Registration with the Internal Revenue Service is not required to establish that a sale of ozone-depleting chemicals is a qualifying sale.

(3) *Certification required.* A sale of ozone-depleting chemicals is not a qualifying sale unless the certification requirements of this section are satisfied.

(b) *Certification requirements.*

(1) *Rigid foam insulation.* A sale of ozone-depleting chemicals is a qualifying sale for purposes of sections II(c) and V(e)(2)(i) of this Notice if the manufacturer or importer of the chemical (the supplier)—

(i) Obtains an exemption certificate in the form set forth in paragraph (d)(2) of this section from the purchaser of the chemical; and

(ii) Relies on the certificate in good faith.

(2) *Feedstocks.* A sale of ozone-depleting chemicals is a qualifying sale for purposes of sections II(e) and V(e)(2)(ii) of this Notice if the supplier—

(i) Obtains an exemption certificate in the form set forth in paragraph (d)(3) of this section from the purchaser of the chemical; and

(ii) Relies on the certificate in good faith.

(c) *Good faith reliance.*

(1) *In general.* The requirement of paragraph (b)(1)(ii) or (2)(ii) of this section (relating to good-faith reliance on a certificate) is not satisfied with respect to a sale of ozone-depleting chemicals and the sale is not a qualifying sale if at the time of the sale—

(i) The supplier has reason to believe that the ozone-depleting chemicals will not be used for the purpose stated in the certificate; or

(ii) The Internal Revenue Service has notified the supplier that the purchaser's right to provide a certificate has been withdrawn.

(2) *Withdrawal of right to provide a certificate.* The Internal Revenue Service may withdraw the right of a purchaser to provide a certificate to its seller if such purchaser uses the ozone-depleting chemicals covered by its certification other than as set forth in such certificate. The Internal Revenue Service may notify the seller to whom the purchaser provided the certificate that the purchaser's right to provide a certificate has been withdrawn.

(d) *Exemption certificates.* The temporary regulations will set forth in this paragraph (d) the form of the exemption certificates that must be provided in qualifying sales under section III(b)(1) and (2) of this Notice. The exemption certificate provided by a purchaser shall consist of a statement executed and signed by the purchaser under penalties of perjury. A certificate may apply to a single purchase or may cover purchases for up to four years from its effective date. A new certificate must be given to the seller if any information on the current certificate changes. The certificate may be included as part of any business records normally used to document a sale.

SECTION IV

IMPORTED TAXABLE PRODUCTS

(a) *In general.* This section provides rules relating to the tax on imported taxable products, including rules for identifying imported taxable products, determining the weight of the ozone-depleting chemicals used as materials in the manufacture of such products, and computing the amount of tax when the weight of such chemicals cannot be determined. See section I(a)(2) and (c) of this Notice for general rules and definitions relating to the tax on imported taxable products.

(b) *Chemicals used as materials.*

(1) *ODC weight.* When used in this section, the term "ODC weight" refers to the weight of the ozone-depleting chemicals used in the manufacture of a product.

(2) *Use as materials in the manufacture of a product.* Except as provided in paragraph (b)(3) of this section, ozone-depleting chemicals are used as materials in the manufacture of a product to the extent the chemicals are—

(i) Incorporated into the product; or

(ii) Released into the atmosphere in the process of manufacturing the product.

(3) *Recycled chemicals.* A chemical that is recycled during the manufacture of a product is not used as a material in its manufacture. For this purpose, a chemical is recycled during the manufacture of a product if—

(i) The chemical is not incorporated into the product; and

(ii) Any release of the chemical into the atmosphere during the manufacture of the product is insignificant and incidental to a process in which the chemical is recovered for use in further manufacture.

(4) *Example.* The following example illustrates the rules of this paragraph (b):

Example. A manufacturer uses ozone-depleting chemicals as solvents to clean the circuit boards it manufactures and as refrigerants in the air-conditioning system of the factory in which the circuit boards are manufactured. The ozone-depleting chemicals used as solvents are released into the atmosphere, but leakage of refrigerants from the air-conditioning system is insignificant. Under this paragraph (b), only the solvents are used as materials in the manufacture of the circuit boards.

(c) *Use of imported products.*

(1) *In general.* The use of an imported product is taken into account for the following purposes:

(i) A product is treated as an imported taxable product only if it is entered into the United States for consumption, use, or warehousing.

(ii) The tax on an imported taxable product is imposed when the product is sold or used by the importer of the product.

(2) *Certain products not entered for consumption, use, or warehousing.* The following products are not entered into the United States for consumption, use, or warehousing (within the meaning of paragraph (c)(1)(i) of this section):

(i) A product brought into the United States for repair.

(ii) A product brought into the United States by an individual if the product is brought in for use by the individual and is not expected to be used in a trade or business other than a trade or business of performing services as an employee.

(3) *Taxable event.* The following rules apply for purposes of paragraph (c)(1)(ii) of this section:

(i) *Use of product by importer.* Except as provided in paragraph (c)(3)(ii) of this section, a product is used by its importer when the importer uses the product in a trade or business or for the production of income. The loss or destruction of a product held in a trade or business or for the production of income is treated as a use for this purpose.

(ii) *Election to treat importation as use.*

(A) *In general.* An importer may elect to treat the entry of products into the United States as the use of such products. If an election under this paragraph (c)(3)(ii) applies to an imported taxable product that is entered into the United States after December 31, 1989, tax is imposed on the product on the date of entry. If such an election applies to an imported product that was entered into the United States before January 1, 1990, no tax is imposed under section 4681 of the Code on the sale or use of the product after December 31, 1989.

(B) *Applicability of election.* An election under this paragraph (c)(3)(ii) applies to all products that are held by the importer at the time the election becomes effective or are entered into the United States by the importer after the election becomes effective.

(C) *Form of election, etc.* An election under this paragraph (c)(3)(ii) is made on Form 6627, *Environmental Taxes*, and becomes effective at the beginning of the calendar quarter to which the form relates. The election may be revoked only with the consent of the Commissioner.

(d) *Imported taxable products.*

(1) *In general.* A product is treated as an imported taxable product for purposes of section 4681 of the Code only if—

(i) The product is listed in the Imported Products Table ("Table") (see paragraph (f) of this section) in effect on the date the product is sold or used; and

(ii) Paragraph (d)(2) of this section does not apply.

(2) *Exceptions.* A product is not treated as an imported taxable product under paragraph (d)(1) of this section if—

(i) The product is listed in Part I of the Table and the taxpayer can establish that the ODC weight of the product is de minimis; or

(ii) The product is listed in Part II of the Table and the taxpayer can establish that—

(A) The ODC weight of the product is de minimis; and

(B) No ozone-depleting chemicals were used as materials in its manufacture for purposes of refrigeration or air conditioning, creating an aerosol or foam, or manufacturing electronic components.

(3) *De minimis ODC weight.*

(i) *In general.* The ODC weight of a product is de minimis if the adjusted tax with respect to the product is less than one/tenth of one percent of the product's cost.

(ii) *Adjusted tax.* The adjusted tax with respect to a product is the tax that would be imposed under section 4681 of the Code on the ozone-depleting chemicals used as materials in the manufacture of such product if such chemicals were sold in the Unit-

ed States and the base tax amount were $1.00.

(iii) *Cost.* The cost of a product is the importer's cost of acquiring such product.

(e) *Computation of tax.* The following rules apply for purposes of computing the amount of tax imposed by section 4681 of the Code on an imported taxable product:

(1) *Exact method.* If the taxpayer determines the weight of each ozone-depleting chemical used as a material in the manufacture of an imported taxable product and can support such determination with sufficient and reliable information, the ODC weight of the product is the weight established by such determination. Sufficient and reliable information includes representations by the manufacturer to the importer as to the weight of the ozone-depleting chemicals used as materials in the manufacture of the product.

(2) *Approximate method; predominant-method ODC weight specified.* If the ODC weight of an imported taxable product is not determined under paragraph (e)(1) of this section and the predominant-method ODC weight of the product is specified in the Table, the ODC weight of the product is the predominant-method ODC weight specified in such table.

(3) *Approximate method; predominant-method ODC weight not specified.* If the ODC weight of an imported product is not determined under paragraph (e)(1) or (2) of this section, the tax imposed on such product under section 4681 of the Code is one percent of the appraised value of such product at the time of entry of such product.

(f) *Imported Products Table.*

(1) *In general.* The table to be used in applying the rules of this section is the Table (set forth in paragraph (f)(4)(i) of this section) in which the Commissioner has specified the imported products that are subject to tax and the predominant-method ODC weight of each listed product for which such weight has been determined.

(2) *Products listed.* Products (other than ozone-depleting chemicals) are listed in the Imported Products Table in accordance with the following rules:

(i) A product is listed in Part I of the Table if the Commissioner has determined that—

(A) The ODC weight of the product is not de minimis when the product is produced using the predominant method of manufacturing the product; and

(B) None of the ozone-depleting chemicals used as materials under the predominant method of manufacturing the product are used for purposes of refrigeration or air conditioning, creating an aerosol or foam, or manufacturing electronic components.

(ii) A product is listed in Part II of the Table if the Commissioner has determined that the ozone-depleting chemicals used as materials under the predominant method of manufacturing the product are used for purposes of refrigeration or air conditioning, creating an aerosol or foam, or manufacturing electronic components.

(3) *Predominant-method ODC weight.* The predominant-method ODC weight of a product is the amount that the Commissioner has determined would be the weight of the ozone-depleting chemicals used as materials in the manufacture of the product if the product were produced using the predominant method of manufacturing the product.

(4) *Initial and subsequent tables.*

(i) *Initial Table.* The temporary regulations will set forth in this paragraph (f)(4)(i) the Table that will apply until superseded by a revenue procedure issued under paragraph (f)(4)(ii) of this section. The initial Table will be issued in a separate Notice.

(ii) *Subsequent Tables.* Tables other than the initial Table shall be published in revenue procedures and shall be effective for the periods prescribed by such revenue procedures.

(g) *Requests for modification of Table.*

(1) *In general.* Any manufacturer or importer of a product may request that the Commissioner modify the Table in any of the following respects:

(i) Adding the product to the Table and specifying the predominant-method ODC weight of such product.

(ii) Removing the product from the Table.

(iii) Moving the product from one part of the Table to the other.

(iv) Changing (or specifying) the predominant-method ODC weight of the product.

(2) *Form of request.* The Commissioner will not consider any request for modification that does not include the following:

(i) For each product with respect to which a modification is requested:

(A) The name of the product;

(B) The Harmonized Tariff Schedule item number prescribed by the United States Customs Service for the product;

(C) The modification requested with respect to the product;

(D) A description of the method that the requester claims is the predominant method of manufacturing the product;

(E) In the case of a modification described in paragraph (g)(1)(i), (ii), or (iv) of this section, the amount that the requester claims would be the weight of the ozone-depleting chemicals used as materials in the manufacture of the product if the product were produced using such predominant method;

(F) In the case of a modification described in paragraph (g)(1)(i) or (ii) of this section, the amount that the requester claims would be the cost of the product if the product were produced using such predominant method of manufacture;

(G) In the case of a modification described in paragraph (g)(1)(i), (ii), or (iii) of this section, a claim by the requester that ozone-depleting chemicals used as materials in the predominant method of manufacturing the product are used for purposes of refrigeration or air conditioning, creating an aerosol or foam, or manufacturing electronic components or that no such chemicals are used for such purposes; and

(H) The data supporting each of the requester's claims.

(ii) The name, address, employer identification number, and principal place of business of the requester.

(3) *Public notice and comments.*

(i) *In general.* Before considering requests for modification, the Commissioner will—

(A) Publish a notice in the Federal Register summarizing requests received during the preceding calendar quarter; and

(B) Request written comments on the proposed modifications.

(ii) *Form of comments.* The Commissioner will not consider written comments on proposed modifications if the comments do not include the following:

(A) An identification of the proposed modification to which the comments relate.

(B) An identification of the statements and supporting data that the commenter claims are incorrect.

(C) The data supporting each of the commenter's claims.

(D) The name, address, employer identification number, and principal place of business of the commenter.

(4) *Address.* The address for submission of requests and comments under this paragraph (g) is: Internal Revenue Service, Attn: CC:CORP:T:R (Imported Products Table), Room 4429, Washington, D.C. 20224.

(5) *Public inspection and copying.* Requests and comments submitted under this paragraph (g) will be available in the Internal Revenue Service Freedom of Information Reading Room for public inspection and copying.

SECTION V

FLOOR STOCKS TAX

(a) *In general.* This section provides rules for identifying the ozone-depleting chemicals that are subject to the floor stocks tax imposed by section 4682(h)(1) of the Code, computing the amount of the tax, and determining whether a person is liable for the tax. See section I(a)(3) and (c) of this Notice for general rules and definitions relating to the floor stocks tax.

(b) *Ozone-depleting chemicals.*

(1) *In general.* The floor stocks tax is imposed only on ozone-depleting chemicals that have not been incorporated into a product (other than an ozone-depleting chemical) before the date on which the tax is imposed. The specific rules in this paragraph (b) are derived from the rule contained in this paragraph (b)(1) and illustrate its application.

(2) *Mixtures.* The floor stocks tax is not imposed on an ozone-depleting chemical that has been mixed with another chemical. For example, the tax is not imposed on the ozone-depleting chemicals contained in the refrigerants commonly known in the industry as R-500 and R-502.

(3) *Manufactured products.* The floor stocks tax is not imposed on an ozone-depleting chemical contained in the manufactured product in which the chemical will be used for its intended purpose. For example, the tax is not imposed on the ozone-depleting chemicals contained in the cooling coils of a refrigerator even if the refrigerator is held for sale.

(4) *Storage containers.* The floor stocks tax is imposed on any ozone-depleting chemical that has not been incorporated into another product. This rule applies without regard to the type or size of the storage container in which the chemical is held. Thus, the tax may apply to an ozone-depleting chemical whether it is in a 14-ounce can or a 30-pound tank.

(c) *Chemicals held for sale or for use in further manufacture.*

(1) *In general.* The floor stocks tax is imposed on a chemical only if, on the date the tax is imposed, the chemical is held for sale or for use in further manufacture. No tax is imposed on a chemical held for any use other than use in further manufacture. This paragraph (c) provides rules for identifying chemicals held for sale or for use in further manufacture.

(2) *Chemicals held for sale.* Chemicals held for sale include chemicals that will be sold in connection with the provision of services or in connection with the sale of another product and, in such cases, include chemicals that will be sold without the statement of a separate charge for the chemicals.

(3) *Chemicals held for use in further manufacture.* A chemical is held for use in further manufacture if—

(i) The chemical will be used as a material (within the meaning of section IV(b) of this Notice) in the manufacture of a product; and

(ii) Such product will be held for sale.

(4) *Examples.* The following examples illustrate the application of this paragraph (c):

Example (1). A, a manufacturer of air conditioners, holds an ozone-depleting chemical for use in air conditioners that it will manufacture and sell. A holds the chemical for use in further manufacture.

Example (2). B, a manufacturer of electronic components, holds an ozone-depleting chemical for use as a solvent to clean circuit boards that it will sell to computer manufacturers. B holds the chemical for use in further manufacture.

Example (3). C, an automobile dealer, holds an ozone-depleting chemical for use in air conditioners installed in automobiles that it sells to retail customers. C does not hold the chemical for use in further manufacture. C does, however, hold the chemical for sale, even if the customers are not separately charged for chemicals used in the automobile air conditioners.

Example (4). D operates an air-conditioning repair service and holds an ozone-depleting chemical for use in repairing air conditioners for its customers. D holds the chemical for sale even if the customers are not separately charged for chemicals used in the repairs.

Example (5). E, a grocery-store chain, holds an ozone-depleting chemical for use in its refrigerator units. E does not hold the chemical for sale or for use in further manufacture.

(d) *Person liable for tax.*

(1) *In general.* The person liable for the floor stocks tax on an ozone-depleting chemical is the person who holds the chemical on the date the tax is imposed. This paragraph (d) provides rules for identifying the person liable for the tax.

(2) *Person.* Each person that has, or is required to have, an employer identification number is treated as a separate person for purposes of the floor stocks tax. For example, a chain of auto-parts stores that has one employer identification number is one person for purposes of the floor stocks tax.

(3) *Chemicals held by a person.* The person who holds a chemical on a date on which the floor stocks tax is imposed is the person who has title to the chemical (whether or not delivery to such person has been made) as of the first moment of such date. The person who has title at such time is determined under applicable local law.

(e) *Computation of tax.*

(1) *In general.*

(i) *Tentative tax amount.* Section I(a)(3) of this Notice provides that the amount of the floor stocks tax on an ozone-depleting chemical is determined by reference to a tentative tax amount. The tentative tax amount is the amount of tax that would be imposed on the chemical under section 4681(a)(1) of the Code if the sale of the chemical by the manufacturer or importer had occurred on the date the tax is imposed. This paragraph (e) provides rules for determining the tentative tax amount and the amount of the floor stocks tax.

(ii) *Floor stocks tax imposed on January 1, 1990.* The floor stocks tax imposed on January 1, 1990, is equal to the tentative tax amount. Thus, except as provided in paragraph (e)(2) or (3) of this section, the amount of the floor stocks tax imposed on January 1, 1990, is as follows:

Ozone-depleting chemical	*Tax per pound*
CFC-11	$1.37
CFC-12	$1.37
CFC-113	$1.096
CFC-114	$1.37
CFC-115	$0.822

(iii) *Subsequent floor stocks taxes.* The following rules apply for floor stocks taxes imposed after January 1, 1990:

(A) The tentative tax amount is determined, except as provided in paragraph (e)(2) or (3) of this section, by reference to the rate of tax prescribed in section 4681(b)(1)(B) of the Code and the ozone-depletion factors prescribed in section 4682(b) of the Code.

(B) The amount of the floor stocks tax on an ozone-depleting chemical is equal to the amount by which the tentative tax amount exceeds the amount of taxes (including floor stocks taxes) previously imposed on the chemical.

(2) *Qualifying sales.*

(i) *Rigid foam insulation.* In the case of an ozone-depleting chemical that was sold in a qualifying sale for purposes of section II(c) of this Notice (relating to rigid foam insulation) the tentative tax amount is determined under section 4682(g) of the Code for purposes of computing the floor stocks tax imposed on the chemical on January 1 of 1990, 1991, 1992, or 1993. For purposes of computing the floor stocks tax imposed on the chemical on January 1, 1990, the tentative tax amount is zero.

(ii) *Feedstocks.* In the case of an ozone-depleting chemical that was sold in a qualifying sale for purposes of section II(e) of this Notice (relating to feedstocks), the tentative tax amount is zero.

(iii) *Chemicals sold before January 1, 1990.* An ozone-depleting chemical that was sold by the manufacturer or importer of the chemical before January 1, 1990, shall be treated, for purposes of this paragraph (e)(2), as—

(A) An ozone-depleting chemical that was sold in a qualifying sale for purposes of section II(c) of this Notice if the chemical will be used in the manufacture of rigid foam insulation (within the meaning of section II(c)(2) of this Notice); and

(B) An ozone-depleting chemical that was sold in a qualifying sale for purposes of section II(e) of this Notice if the chemical will be used as a feedstock (within the meaning of section II(e)(2) of this Notice.

(3) *Halons.* In the case of halon-1211, halon-1301, or halon-2402, the tentative tax amount is determined under section 4682(g) of the Code for purposes of computing the floor stocks tax imposed on the chemical on January 1 of 1990, 1991, 1992, or 1993. For purposes of computing the floor stocks tax imposed on the chemical on January 1, 1990, the tentative tax amount is zero.

(f) *De minimis exemption.*

(1) *Floor stocks tax imposed on January 1, 1990.*

(i) *In general.* A person is not liable for the floor stocks tax imposed on January 1, 1990, unless the person holds at least 400 pounds of ozone-depleting chemicals to which the tax applies. For this purpose, an ozone-depleting chemical described in paragraph (e)(2) or (3) of this section is treated as a chemical to which the tax does not apply.

(ii) *Examples.* The following examples illustrate the rules of this paragraph (f)(1):

Example (1). On January 1, 1990, A holds 300 pounds of ozone-depleting chemicals for sale. A is not liable for the floor stocks tax imposed on January 1, 1990.

Example (2). On January 1, 1990, B holds 1,500 pounds of ozone-depleting chemicals. B will use 1,300 pounds of these chemicals in the manufacture of rigid foam insulation. Thus, the floor stocks tax applies to only 200 pounds of the chemicals, and B is not liable for the floor stocks tax imposed on January 1, 1990.

(2) *Floor stocks taxes imposed after 1990.* [Reserved.]

(g) *Inventory.* If, on the date on which the floor stocks tax is imposed, a person (including a person who is not liable for the floor stocks tax) holds ozone-depleting chemicals for sale or for use in further manufacture, the following rules apply:

(1) The person shall prepare an inventory of all such ozone-depleting chemicals that the person holds on the date on which the tax is imposed.

(2) The inventory shall be taken as of the first moment of the date on which the tax is imposed, but work-back or work-forward inventories will be acceptable if supported by adequate commercial records of receipt, use, and disposition of ozone-depleting chemicals held for sale or for use in further manufacture.

(3) The person must maintain records of the inventory and make such records available for inspection and copying by internal revenue agents and officers. Records of the inventory are not to be filed with the Internal Revenue Service.

(h) *Time and place for paying tax.* The floor stocks tax on ozone-depleting chemicals is due and payable without assessment or notice on or before April 1, 1990. The tax must be deposited on or before April 1, 1990, together with Form 8109, *Federal Tax Deposit Coupon*, at an authorized depositary or the Federal Reserve Bank serving the taxpayer's area.

(i) [Reserved.]

(j) *Requirements relating to return.*

(1) *Form.* Every person liable for the floor stocks tax on ozone-depleting chemicals shall make a return of tax on Form 720, *Quarterly Federal Excise Tax Return*, to which Form 6627, *Environmental Taxes*, is attached.

(2) *Time and place for filing a return.* The return shall be filed with the Service Center indicated by the

instructions on the Form 720. In the case of a taxpayer not otherwise required to file Form 720, the return must be filed by May 10, 1990, and must be marked "Final." In the case of all other persons, the return reporting floor stocks tax liability, and any other excise tax liability, must be filed on or before the date prescribed by the instructions for the Form 720 for the quarter ending March 31, 1990. Only one return should be filed for a quarter.

SECTION VI

ADMINISTRATIVE PRONOUNCEMENT AND DRAFTING INFORMATION

The collection of information contained in this Notice has been approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3507). The estimated average burden associated with the collection of information in this Notice is 0.4 hour per respondent and 0.5 hour per recordkeeper.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents/recordkeepers may require greater or less time, depending on their particular circumstances.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the Internal Revenue Service, Washington, D.C. 20224, Attention: IRS Reports Clearance Officer T:FP; or to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503.

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Imported Products Table; Ozone-Depleting Chemicals Tax

Notice 90-9

This Notice informs the public of the products that are subject to the tax on imported products containing chemicals that deplete the ozone layer. Additional rules relating to this tax are contained in Notice 90-8, page 305, this Bulletin. The rules in this Notice and Notice 90-8 reflect amendments made by section 7506 of the Revenue Reconciliation Act of 1989 (Act) to the Internal Revenue Code (Code). Section 7506 of the Act added sections 4681 and 4682 (relating to the tax on ozone-depleting chemicals) to the Code. The table in this Notice applies only to imported products sold or used after December 31, 1989, and before the date on which temporary regulations under section 4682 are published in the Federal Register.

I. IN GENERAL

Section IV of Notice 90-8 provides rules for computing the amount of tax imposed under section 4681 of the Code on an imported product. Under those rules, the applicability of the tax to an imported product and, in certain circumstances, the amount of tax imposed on the product is determined by reference to a table prescribed by the Commissioner. A table will be issued in temporary regulations under section 4682.

This Notice sets forth a preliminary table based on information submitted by industry representatives and provides rules relating to the use of the table. Taxpayers may rely on the table contained in this Notice until temporary regulations are published and may compute the amount of tax imposed on an imported product sold or used after December 31, 1989, and before the date on which the temporary regulations are published by reference to the table contained in this Notice or by reference to the table contained in the temporary regulations.

II. USE OF TABLE

The table in this Notice is to be used in accordance with the following rules:

(a) Rigid foam insulation. In computing the tax on an imported product under section I(a)(2) of Notice 90-8, the tax that would be imposed on an ozone-depleting chemical (ODC) used as a material in the manufacture of the product is determined under section 4682(g) of the Code (relating to the phase-in of tax on certain substances) if the chemical was used in the manufacture of rigid foam insulation. If the table contained in this Notice is used in computing the tax on an imported product under the approximate method described in section IV(e)(2) of Notice 90-8, any chemical with a weight that is followed by an asterisk (*) shall be treated as a chemical used in the manufacture of rigid foam insulation.

(b) Protective packaging. The protective packaging of a listed product is not taken into account in computing the tax on the product under the exact method described in section IV(e)(1) of Notice 90-8.

(c) Coordination with exact method. A taxpayer who cannot establish the weight of each ozone-depleting chemical used as a material in the manufacture of an imported product cannot use the exact method described in section IV(e)(1) of Notice 90-8. If, however, the taxpayer determines the weight of any such chemical and can support such determination with sufficient and reliable information, the taxpayer may substitute the weight established by such determination for the weight specified in the table contained in this Notice. For example, if a taxpayer uses sufficient and reliable information to determine the amount of CFC-12 included in a product as a refrigerant but cannot determine the amount of CFC-113 used in manufacturing the product's electronic components, the taxpayer may use the ODC weight from the table for CFC-113 and the weight determined by the taxpayer for CFC-12.

(d) Listed products. Each listing in the table identifies an imported taxable product by name and includes only products that are described by such name. Some listings also identify imported taxable products by Harmonized Tariff Schedule (HTS) item number. In such cases, the listing includes only products on which the rate of duty is determined by refer-

ence to such HTS item number. For example, the table identifies computers by name (see listings for ADP units) and by HTS number 8471. The listings do not include computers entered under HTS number 9801, 9802, 9803, or 9813 (relating to items exported and returned). Accordingly, computers assembled outside the United States from components manufactured in the United States are not taxed because the duty on such computers is determined under HTS number 9802.00.80.

III. IMPORTED PRODUCTS TABLE

The table used in applying the rules of section IV of Notice 90-8 is set forth below. The ODC weight is given in lbs/unit unless otherwise specified.

PART I

(Imported products for which the ODC weight is not de minimis and in the manufacture of which ozone-depleting chemicals have not been used for purposes of refrigeration or air conditioning, creating an aerosol or foam, or manufacturing electronic components.)

Item	*Harmonized Tariff Schedule Number*	*ODC*	*ODC Weight*
Mixtures containing CFC's:			
Refrigerants			
Dusting sprays			
Electronic solvents			
Cleaning solvents			
Electronic circuit board coolants			
Flux removers for electronics			
Contact cleaners			
Degreasers			
Propellants			
Ethylene oxide/CFC-12 mixture		CFC-12	0.88
Insect and wasp sprays			
Anti-static sprays			
Automotive products such as "carburetor cleaner", "stop leak", "oil charge"			
Polyethylene products (film, wrap)	3901.10/20 3915.10 3916.10 3917.21/32 3920.10/62 3923.21 3926		
Spectacle lenses	9001.40-50		

PART II

(Imported products in which ozone-depleting chemicals have been used for purposes of refrigeration or air conditioning, creating an aerosol or foam, or manufacturing electronic components.)

Item	*Harmonized Tariff Schedule Number*	*ODC*	*ODC Weight*
Aircraft:			
140 passenger			
(w/o engine and landing gear)		CFC-113	1900.
on board refrigeration system			15.
engine and landing gear			285.
300 passenger			
(w/o engine and landing gear)		CFC-113	7000.
on board refrigeration system			40.
engine and landing gear			1050.
Rigid foam insulation:			
extruded polystyrene	3903.11	CFC-12	0.07
polyurethane	3909.50	CFC-11	0.10
phenolic		CFC-12 CFC-11	
polyethylene		CFC-113 CFC-114	
other		CFC-12	

Item	*Harmonized Tariff Schedule Number*	*ODC*	*ODC Weight*
Packaging foams:			
polyurethane		CFC-11	
extruded polystyrene		CFC-12	
polyethylene		CFC-114	
		CFC-12	
polypropylene		CFC-12	
polyolefin			
Foam systems:			
not used for insulation		CFC-11	
used for insulation		CFC-11	
		CFC-12	
Components-Compressors:	8414.3	CFC-113	0.02357
rotary (large)		CFC-113	0.00459
rotary (small)		CFC-113	0.00734
reciprocal (large)		CFC-113	0.00547
reciprocal (small)		Unknown	0.004
refrigerator		CFC-113	0.00435
room a/c			
Room air conditioners (2520–4284 Kcal/hr)	8415.10.00.60	CFC-113	0.15
Chillers	8415.82.0065		
Dehumidifiers	8415.82.50	CFC-12	0.90
Automotive a/c	8415.83.00.40	CFC-113	0.40
Compact refrigerator-freezers	8418.10.00.10	CFC-11	1.08*
		CFC-12	0.19
Refrigerator-freezers:			
exceeding 184 but not 269 liters	8418.10.00.20	CFC-11	1.32*
		CFC-12	0.26
exceeding 269 but not 382 liters	8418.10.00.30	CFC-11	1.54*
		CFC-12	0.35
exceeding 382 liters	8418.10.00.40	CFC-11	0.45*
		CFC-12	0.11
Compact refrigerator-freezers	8418.21.00.10	CFC-11	0.5*
		CFC-12	0.13
		CFC-11	0.45*
		CFC-12	0.11
Household refrigerators	8418.21-29		
—insulation		CFC-11	2.0*
—refrigerant		CFC-12	0.38
—other		CFC-113	0.03
Chest freezers	8418.30		
—refrigerant		CFC-12	0.5
—insulation		CFC-11	2.0*
		CFC-115	0.3
Freezers	8418.50	CFC-12	260.0
		CFC-11	50.0*
Icemaking machines	8418.69.00.10		
charged with CFC-12		CFC-12	1.4
charged with R-500		CFC-12	4.9
Drinking water coolers	8418.69.00.20		
charged with CFC-12		CFC-12	0.21
charged with R-500		CFC-12	0.22

Item	*Harmonized Tariff Schedule Number*	*ODC*	*ODC Weight*
Chillers:			
hermetic centrifugal	8418.69.0050		
charged with CFC-12		CFC-12	1600.
charged with CFC-114		CFC-114	1250.
charged with R-500		CFC-12	1920.
reciprocating	8418.69.0060	CFC-12	200.
Mobile refrigeration systems:	8418.99		
containers		CFC-12	15.
trucks		CFC-12	11.
trailers		CFC-12	20.
Refrigeration condensing units:	8418.99		
not exceeding 746W		CFC-12	0.3
exceeding 746W but not 2.2KW		CFC-12	1.0
exceeding 2.2 but not 7.5 KW		CFC-12	3.0
exceeding 7.5 but not 22.3KW		CFC-12	8.5
exceeding 22.3 KW		CFC-12	17.0
Dishwashers	8422.11	CFC-113	0.2
Transistors	8441.21	CFC-113	0.0005
Coin-operated washers	8450.11.00.10	CFC-113	0.2
Automatic clothes washers	8450.11.00.90	CFC-113	0.07
Clothes dryers	8451.21.00.90	CFC-113	0.02
Typewriters and word processors	8469	CFC-113	0.2049
Calculators and account machines	8470	CFC-113	0.1913
Digital DP machine w/CRT (laptops)	8471.20	CFC-113	0.3663
ADP units over $100K	8471.91XX	CFC-113	27.6667
ADP units (CPUs) $100K and under	8471.91YY	CFC-113	0.4980
Terminals (combined I/O)	8471.92.10	CFC-113	0.3600
Keyboards	8471.92.20	CFC-113	0.0742
Displays	8471.92.30/40	CFC-113	0.6573
Printers	8471.92.65/70	CFC-113	0.1558
All other I/O	8471.92.80/90	CFC-113	0.1370
Disk drives over 21 CM	8471.93.10/15	CFC-113	4.0067
Disk drives not over 21 CM "Hard"	8471.93.30/40	CFC-113	1.1671
Non mag disk storage	8471.93.50	CFC-113	2.7758
Other office machines	8472	CFC-113	0.0010
Parts and accessories of ADP not otherwise listed	8473	CFC-113	0.01
Populated cards over $2000	8473WW	CFC-113	4.82
Populated cards not over $2000	8473XX	CFC-113	0.1408
Mechanical assemblies	8473YY	CFC-113	0.0005
Other parts and accessories of ADP	8473ZZ	CFC-113	0.0615
Vending machines with refrigerating device	8476.11	CFC-12	0.45
Power supply	8504	CFC-113	0.0655

Item	*Harmonized Tariff Schedule Number*	*ODC*	*ODC Weight*
Nickel cadmium batteries	8507.30	CFC-113	0.0005
Microwave ovens:	8516.50		
small		CFC-113	0.03
medium		CFC-113	0.0438
large		CFC-113	0.14
Electric magnetic cookers	8516.60.40.90	CFC-113	0.01
Toasters	8516.72	CFC-113	0.1855
Electrical apparatus for telephone and telegraph not otherwise listed	8517	CFC-113	0.09
Telephones	8517.10	CFC-113	0.1
Telephone handsets	8517.10 8518.3010 8518.9010 8525.2050	CFC-113	0.042
Switching equipment	8517.30	CFC-113	0.1267
Fiber optic transmission equipment	8517.30/40/90	CFC-113	0.0225
Private branch exchanges	8517.3020	CFC-113	0.0753
Audio systems	8518.21/30/50 8519.31/99 8520.31 8527.39/40/60	CFC-113	0.0022
Portable tape/CD players	8519.910040/45/60/80 8520.31 8527.1111/1120	CFC-113	0.0029
Answering-recording devices	8520.20	CFC-113	0.1
Videodisc players	8521.90	CFC-113	0.0106
Cellular communication equipment	8525.206020/60/70	CFC-113	0.4446
TV cameras	8525.30 8529.9030	CFC-113	1.423
Videocassette recorders	8525.30 8528.1040	CFC-113	0.0586
Cordless telephones	8525	CFC-113	0.1
Radios	8527.19/32	CFC-113	0.0014
Autosound equipment	8527.21 8519.910020	CFC-113	0.0021
Televisions	8528	CFC-113	0.0386
Home satellite earth stations	8528.1080551	CFC-113	0.0106
Electronic assemblies	8529.90	CFC-113	0.0998
Indicator panels (L.E.D. and L.C.D.)	8531	CFC-113	0.0146
Capacitors	8532	CFC-113	0.0012
Resistors	8533	CFC-113	0.0005
Networks (pulse forming resistors, networks, etc.)	8533	CFC-113	0.0333

Item	*Harmonized Tariff Schedule Number*	*ODC*	*ODC Weight*
Printed circuit boards not otherwise listed	8534	CFC-113	0.5776
Raw boards	8534.00.00.20	CFC-113	0.001
Other printed circuits	8534.00.00.60	CFC-113	0.01
Keypad electrical parts	8536	CFC-113	0.0025
Switches	8536.50	CFC-113	0.0008
Connectors	8536.69	CFC-113	0.0015
Computerized numerical controls	8537.100030	CFC-113	0.1306
Cathode/photocathode tubes not otherwise listed	8540	CFC-113	0.0101
Other photocathode tubes	8540.30.00.00	CFC-113	0.9143
Magnetrons	8540.41.20	CFC-113	
Diodes, crystals transistors and similar integrated circuits (I.C.'s) not otherwise listed	8541	CFC-113 CFC-12	0.0004 0.002
Diodes	8541.00/40	CFC-113	0.0027
Electronic filters	8541.600080	CFC-113	0.05
Semiconductor devices	8541.10/40/50 8542.11/19/20/80/90	CFC-113	0.0227
Electronic I.C.'s and microassemblies not otherwise listed	8542	CFC-113	0.0455
Microcircuits	8542.11/80/90	CFC-113	0.0052
Hybrid circuits	8542.20	CFC-113	0.0119
Parts of I.C.'s	8542.90	CFC-113	0.0165
Digital unmounted	8542.11.00.02	CFC-113	0.0002
Other unmounted	8542.19.00.40	CFC-113	0.0058
Electrical machinery not otherwise listed	8543	CFC-113	0.6518
Parts of electrical machinery	8543.90	CFC-113	0.1265
Avionics	8543.9040 9014.20	CFC-113	0.915
Tank cars	8606	CFC-11	100.*
Lawn mowers and riding mowers			
Passenger automobiles	8703		
—with charged a/c			
a/c		CFC-12	
electronics		CFC-113	
foams		CFC-11	
—without charged a/c			
a/c		CFC-12	
electronics		CFC-113	
foams		CFC-11	
—without a/c			
electronics		CFC-113	
foams		CFC-11	

Item	*Harmonized Tariff Schedule Number*	*ODC*	*ODC Weight*
Light trucks	8704		
—with charged a/c		CFC-12	
		CFC-113	
		CFC-11	
—without charged a/c		CFC-12	
		CFC-113	
		CFC-11	
—without a/c		CFC-113	
		CFC-11	
Motorcycles	8711	CFC-11	0.04
Bicycles	8712	CFC-11	0.04
Optical fibers	9001	CFC-12	0.005/thousand feet
Cameras	9006	CFC-113	0.01
Photocopiers	9009	CFC-113	0.0426
Drafting machines	9017	CFC-113	0.12
Medical products: surgical staplers cryogenic medical instruments drug delivery systems inhalants			
Medical instruments not otherwise listed	9018	CFC-113	3.4163
		CFC-12	0.94
Parts of medical instruments	9018.90	CFC-113	1.9320
Physical or chemical analysis instruments not otherwise listed	9027	CFC-113	0.0271
		CFC-12	0.0003
Parts of analysis instruments	9027.90	CFC-113	0.0271
		CFC-12	0.0337
Electrical quantity checking instruments not otherwise listed	9030	CFC-11	0.49
		CFC-12	0.5943
		CFC-113	0.2613
Telephone testing equipment	9030.40	CFC-113	0.3025
Parts of testing instruments	9030.90	CFC-11	0.49
		CFC-12	0.5833
		CFC-113	0.4187
Foam chairs	9401	CFC-11	0.30
Foam sofas: double seat cushion three-four seat cushion	9401	CFC-11	0.75
Foam mattresses: single-double queen-king	9404.21	CFC-11	1.60
Pillows		CFC-11	
Foam toys		CFC-11	
Carpet backing		CFC-11	
Scrap flexible foam		CFC-11	
Video games	9504.10		

Item	*Harmonized Tariff Schedule Number*	*ODC*	*ODC Weight*
Electronic components not otherwise listed			0.0004/$1.00 value
Consumer electronics products not otherwise listed			0.0001/$1.00 value
Telecommunications products not otherwise listed			0.0006/$1.00 value

IV. ADMINISTRATIVE PRONOUNCEMENT

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

New Tax on Transportation by Water

Notice 90-10

The Revenue Reconciliation Act of 1989 (The Act) imposes a new tax on certain travel on commercial vessels. The tax, which is imposed by new section 4471 of the Internal Revenue Code, is $3 for each passenger on any voyage of a commercial passenger vessel having berth or stateroom accommodations for more than 16 passengers if the voyage extends over one or more nights. This tax also applies with respect to passengers on any commercial vessel that transports passengers engaged in gambling beyond the territorial waters of the United States, whether or not the voyage is overnight. For purposes of this tax, a vessel is considered to be beyond the territorial waters of the United States (which means the States and the District of Columbia) if it is outside the three mile limit. (No inference is intended as to the extent of the territorial limits for other federal tax purposes.) The tax applies only once for each passenger on a taxable voyage, either at the time of the first embarkation or disembarkation in the United States. The tax is imposed on the operator of the commercial vessel.

The tax does not apply to any voyage on any vessel owned or operated by the United States, a State, or any agency or subdivision thereof. The tax also does not apply to a voyage of a passenger vessel of less than 12 hours between 2 ports in the United States, unless the vessel is a commercial vessel that transports passengers engaged in gambling beyond the territorial waters of the United States.

The tax is effective for any voyage beginning after December 31, 1989, that is not paid for on or before that date. For purposes of the effective date provision, a voyage is considered paid for when full payment for the voyage is received by the operator or the operator's agent.

The Act provides that no deposits of tax are required before April 1, 1990. Further guidance regarding payments and deposits of tax will be provided in the future.

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure. See Rev. Rul. 87-138, 1987-2 C.B. 287.

Current Liability Interest Rate

Notice 90-11

This notice provides guidance under Internal Revenue Code section 412 as to the reasonable interest rate within the permissible range that is to be used for purposes of determining the current liability of a plan. The current liability is a component of the full funding limitation for plan years commencing after December 31, 1987, as well as the basis for determining the additional funding requirement (if any) of section 412(l) for plan years commencing after December 31, 1988. In addition, the notice provides certain valuation rules that are to be used in calculating the current liability of a plan.

Background

Section 412(c)(7), as amended by section 9301 of the Omnibus Budget Reconciliation Act of 1987 (OBRA 87), provides that the full funding limitation of a pension plan for a plan year is the excess (if any) of (i) the lesser of (A) 150 percent of current liability, or (B) the accrued liability (including normal cost) under the plan (determined under the entry age normal funding method if such accrued liability cannot be directly calculated under the funding method used for the plan) over (ii) the lesser of (A) the fair market value of the plan's assets, or (B) the value of such assets determined under paragraph (2) of section 412(c).

Section 404(a)(1)(A) of the Code provides that the amount deductible with respect to a defined benefit pension plan may not exceed the full funding limitation of section 412 of the Code. Therefore, the changes made by section 9301 of OBRA 87 limit the maximum amount deductible with respect to plan years beginning after December 31, 1987, to the amount needed, if any, to increase the plan's assets to the lesser of 150 percent of current liability or the accrued liability under the plan.

Section 412(b)(5) of the Code, as amended by section 9307 of OBRA 87, provides that in determining current liability the interest rate to be used shall be within the permissible range that is not more than 10 percent above and not more than 10 percent below the weighted average of the rates on 30-year Treasury securities during the 4-year period ending on the last day before the beginning of the plan year, and shall be consistent with the assumptions which reflect the purchase rates which would be used by insurance companies to satisfy the liabilities under the plan.

Section 412(l) provides additional minimum funding requirements for plan years beginning after December 31, 1988, for defined benefit pension plans (other than multi-employer

plans) that have an unfunded current liability.

Notice 88-73, 1988-2 C.B. 383, set forth the methodology used to determine the permissible range. Also, Notice 88-73 provided the permissible range for plan years commencing in January and February 1988. Subsequent notices have provided the permissible range for plan years commencing during subsequent months of 1988. These notices did not provide guidance as to what rate within the permissible range is to be used in determining the current liability of any plan.

Notice 89-31, 1989-1 C.B. 671, provided guidance on the interest rate within the permissible range that may be used to determine current liability for plan years commencing in 1988.

Interest Rate

Until future guidance provides otherwise, for plan years commencing after December 31, 1988, the interest rate that is to be used to determine current liability must be an interest rate that (1) is not less than 90 percent of the weighted average of 30-year Treasury securities (i.e., the lower end of the permissible range) for the relevant period and (2) is not greater than 110 percent of the weighted average of 30-year Treasury securities (i.e., the upper end of the permissible range) for the relevant period ("qualifying current liability interest rate"). The interest rates specified in the previous sentence are deemed to be consistent with the assumptions that reflect the purchase rates that would be used by insurance companies to satisfy the liabilities under a plan upon plan termination. No interest rate other than those specified in this notice may be used to compute current liability.

Example 1—The plan year of defined benefit plan A is the calendar year. For the 1989 calendar year, based on the weighted average of the rates of 30-year Treasury securities for the 4-year period ending on December 31, 1988, the permissible range is 7.92 percent to 9.68 percent. Accordingly, under this notice, the qualifying current liability interest rate must be any interest rate from 7.92 percent to 9.68 percent. No interest rate less than 7.92 percent (e.g., 7.91 percent or 7.90 percent) may be used and no interest rate greater than 9.68 percent (e.g., 9.69 percent or 10.00 percent) may be used.

Valuation Rules

General rule. In determining the current liability for a plan, a qualifying current liability interest rate is to be used together with the actuarial assumptions that satisfy the requirements of section 412(c)(3) of the Code to determine the present value of benefits payable at all possible ages under the plan and under all possible optional forms of benefit available under the plan in a manner consistent with the probability that each such benefit will be paid. The probability that a particular benefit will be paid is determined under the actuarial assumptions made for the plan. Such actuarial assumptions must be the same assumptions used for calculating other costs for the funding standard account (e.g., normal cost, accrued liability, etc.). Section 412(b)(5)(B) requires that any interest rate used under the plan to determine cost must be within the permissible range defined in that section. Thus, in general, for purposes of determining current liability, the amount of any benefit payable in any form under the plan and the present value of such an amount must be determined using a qualifying current liability interest rate. For purposes of determining current liability, if the actuarial assumptions include an assumption as to the rate of future salary increases (i.e., a salary scale), the salary increase may be used only to compute the expected increase in accrued benefits through the end of the plan year and may not be used to project increases in accrued benefits for later years.

Exception. In order to meet existing requirements other than the determination of current liability, employers with plans providing a benefit payable as a nondecreasing annuity generally already calculate the amount of benefit payable with regard to such an annuity using an interest rate specified in the plan. In light of the generally applicable methods for valuing nondecreasing annuities, this notice provides the following exception to the general rule for determining current liability in the case of nondecreasing annuities for a period not less than the life of the participant (a life annuity). Under this exception, the amount of any such life annuity benefit is determined under the terms of the plan (including the interest rate specified in the plan) and then the present value of such amount is determined using a qualifying current liability interest rate. This exception to the general rule for determining current liability is provided for administrative convenience while retaining a uniform rule for all employers and must be applied in all cases to value a nondecreasing annuity form of benefit as described above.

Transition Rule. Because the current liability may have been calculated for plans by determining plan benefits in a manner that is not consistent with the valuation rules as set forth in this notice, a transition rule is being provided with respect to plan years commencing prior to January 1, 1990. Under this transition rule, the amount of any benefit payable in any form under the plan may be determined either in accordance with the valuation rules as set forth in this notice or in accordance with a reasonable interpretation of the statute. Thus, for example, for plan years commencing prior to January 1, 1990, the amount of a single sum distribution may be determined using either the terms of the plan or a qualifying current liabililty interest rate and then the present value of such amount is determined using a qualifying current liability interest rate.

Example 2—Plan *A* has one participant *P* who is age 45. The normal retirement age of plan *A* is age 65. Plan *A* also provides that retirement benefits may be paid at any time after the attainment of age 55 in an amount equal to the participant's accrued benefit without reduction for payment before age 65 (i.e., a subsidized early retirement benefit). The automatic form of retirement benefit is a qualified joint and survivor annuity that is the actuarial equivalent of the single life annuity normal form of benefit using an interest rate of 5 percent and the 1983 GAM mortality table. Furthermore, Plan *A* provides that in lieu of taking retirement benefits in the form of an annuity, a participant (with spousal consent)

may elect to receive retirement benefits in a single sum distribution. The amount of the single sum distribution is the present value of the accrued single life annuity payable at normal retirement age. Under the plan, the single sum is determined using an interest rate of the lesser of 5 percent or the applicable interest rate under section 417(e) of the Code. Participant *P* has an accrued benefit payable as a single life annuity at normal retirement age of $1,000 per month. The actuarial assumptions used for Plan *A* for the plan year beginning in 1990 (other than the interest rate assumption) are as follows:

Retirement age	65
Pre-retirement mortality	none
Post-retirement mortality	1983 GAM
Turnover	none
Form of benefit	single sum

Assuming that each of these assumptions is reasonable, the current liability is determined as the present value of all benefits under the plan using the current liability interest rate and the other actuarial assumptions specified above. Under the actuarial assumptions, the probability of payment of benefits prior to age 65 is zero. Accordingly, the current liability is the value of the benefits payable at age 65. Under the actuarial assumptions, the form of benefit is a single sum distribution. Accordingly, the current liability for the plan year beginning in 1990 is the present value of a single life annuity of $1,000 per month using the 1983 GAM mortality table and a qualifying current liability interest rate. Assuming that an interest rate of 9.0% is used, the current liability is $17,384.

Example 3—Assume that Plan B provides the same benefits and uses the same actuarial assumptions as in Example 2 for Plan A except that it is assumed that 50 percent of the retirements will take place at age 60 with the remainder at age 65, that all retirements at age 60 will take a life annuity, and that all retirements at age 65 will take a single sum. Further, assume that there are 20 participants in plan B of whom 10 are aged 45 with an accrued benefit payable as a single life annuity commencing at normal retirement age of $1,000 and 10 are aged 50 with an accrued benefit of $1,500. Assuming that an interest rate of 8.5% is used to determine current liability, the current liability for the plan year beginning in 1990 is determined as follows:

(1) Compute the present value of accrued benefits for the participants who are age 45 using the actuarial assumptions specified for plan B. This is $262,228; the sum of

(a) $163,927, which is determined as follows: $111,462 (the present value at age 60 of an immediate annuity of $1,000 per month using 8.5 percent interest and the 1983 GAM mortality table) multiplied by 10 (the number of age 45 participants) multiplied by .5 (the probability that retirement will take place at age 60) multiplied by .29414 (a 15 year discount factor at 8.5 percent); plus

(b) $98,301, which is determined as follows: $100,502 (the present value at age 65 of an immediate annuity of $1,000 per month using 8.5 percent interest and the 1983 GAM mortality table) multiplied by 10 (the number of age 45 participants) multiplied by .5 (the probability that retirement will take place at age 65) multiplied by .19562 (a 20 year discount factor at 8.5 percent).

(2) Compute the present value of accrued benefits for the participants who are age 50 in the same manner as was done for the participants who are age 45. This is $591,452 (the sum of $369,739 plus $221,713).

(3) Add the current liabilty determined for the age 45 particpants ($262,228) plus the current liability determined for the age 50 participants ($591,452) to obtain the total current liability of $853,680.

Administrative Pronouncement

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Weighted Average Interest Rate Update

Notice 90-12

Notice 88-73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of section 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 (OBRA 1987).

The notice also provides that an announcement will be published monthly to provide the weighted average and the permissible range for the plan years beginning each month. The following rates were determined for the plan years beginning in the months shown below.

Month Year	Weighted Average	Permissible Range
January 1990	8.56	7.71 to 9.42

Administrative Pronouncement

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Domestic Asset/Liability Percentage and Domestic Investment Yield

Notice 90-13

I. *Introduction.* This Notice provides the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under section 842(b) of the Internal Revenue Code for taxable years beginning after December 31, 1988. Instructions are provided for computing foreign insurance companies' liabilities for the estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 1988. For more specific guidance regarding the computation of the amount of net investment income to

be included by a foreign insurance company on its U.S. income tax return, see Notice 89-96, 1989-2 C.B. 417.

II. *Domestic Asset/Liability Percentages for 1989.* The Secretary determines the domestic asset/liability percentage separately for life insurance companies and property and liability insurance companies. For the first taxable year beginning after December 31, 1988, the relevent domestic asset/liability percentages are:

117.2 percent for foreign life insurance companies, and 151.6 percent for foreign property and liability insurance companies.

III. *Domestic Investment Yields for 1989.* The Secretary is required to prescribe separate domestic investment yields for foreign life insurance companies and for foreign property and liability insurance companies. For the first taxable year beginning after December 31, 1988, the relevent domestic investment yields are:

8.7 percent for foreign life insurance companies, and 6.7 percent for foreign property and casualty companies.

IV. *Asset/liability percentages and domestic investment yields for 1988.* Notice 89-96 published the asset/liability percentages and domestic investment yields for the first taxable year beginning after December 31, 1987. In its initial calculation of the percentages required under section 842, Treasury relied on industry analysis submitted by representatives of the foreign life insurance industry to determine the fraction of a figure reported on the NAIC statement to be included in "total insurance liabilities" of foreign life insurance companies. The industry representatives have subsequently determined that their analysis was in error and have submitted evidence indicating the correct fraction to be included. Treasury has reviewed this evidence, concurs with the corrected value, and has used this fraction to obtain the 1989 percentages published here. No change is being made to the 1988 percentages. Those numbers were determined using the best information available to Treasury at that time.

V. *Estimated Taxes.*

To compute estimated tax and the installment payments of estimated tax due for taxable years beginning after December 31, 1988, a foreign insurance company must compute its estimated tax payments by adding to its income other than net investment income the greater of (i) its net investment income, as determined under section 842(b)(5), that is actually effectively connected with the conduct of a trade or business within the United States for the relevant period, or (ii) the minimum effectively connected net investment income under section 842(b) that would result from using the most recently available domestic asset/liability percentage and domestic investment yield. Thus, for installment payments due after the release of this Notice, the domestic asset/liability percentages and the domestic investment yields provided in this Notice must be used to compute the minimum effectively connected net investment income. However, if the due date of an installment is less than 20 days after the date this Notice is published in the Internal Revenue Bulletin, the asset/liability percentages and domestic investment yields provided in Notice 89-96 may be used to compute the minimum effectively connected net investment income for such installment. For further guidance in computing estimated tax, see Notice 89-96.

VI. *Procedural Information*

This Notice serves as an "administrative pronouncement" as that term is used in section 1.6661-3(b)(2) of the regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Employee Business Expense Reimbursements

Notice 90-14

PURPOSE

This notice provides guidance on how to claim an "above-the-line" deduction (an adjustment to income) for business expenses, such as travel and transportation expenses, if your employer has reported amounts on your Form W-2 that were permitted, but not required to be reported. This special guidance applies only if you were reimbursed for business expenses on a per diem or mileage basis for 1989.

BACKGROUND

I. *Who needs to make this adjustment?*

a. *In general.* Some employees who received reimbursements or other expense allowances from their employers in 1989 will have amounts reported in Box 10 (Wages, tips, other compensation) of their Forms W-2 even though the amounts were not required to be reported. This notice provides a procedure for an adjustment to income (commonly known as an "above-the-line" deduction) in such cases. This notice applies to you only if you have such overreported amounts in Box 10, and if your employer has reported in Box 10 all per diem or mileage reimbursements and allowances paid to you under the arrangement.

b. *Most employees who were reimbursed for business expenses do not need to make this adjustment.* Many employers reimburse their employees for their actual business expenses. Likewise, many employers reimburse their employees for business travel and transportation expenses using a per diem allowance that is less than or equal to the applicable Federal per diem or using a mileage allowance that is less than or equal to the standard mileage rate (25.5 cents per mile for 1989). Generally, those amounts will not appear in Box 10 of your W-2, and in such case you should disregard this notice entirely.

c. *Who might need to make this adjustment to income?* If you received per diem allowances for travel (e.g., a flat rate per day of travel to cover expenses) instead of being reimbursed for your actual expenses, you may need to make this adjustment because the entire amount of all those allowances may have been included in Box 10 under a special reporting rule available for employers in 1989. Also, if you were reimbursed for business use of your personal auto at a rate higher than the standard mileage rate of 25.5 cents per mile, you may have to make this adjustment because the entire amount may have been included in Box 10 under the 1989 special reporting rules. These special reporting rules were provided for employers

for 1989 because specific guidelines on reporting these types of reimbursement were not available until December 12, 1989.

d. *How do I know whether my employer overreported amounts in Box 10 and whether the amount in Box 10 includes all my reimbursements and allowances?* You can make this determination either by checking your own records or by asking your employer. For example, compare your salary, pay stubs, and other payroll information against the amount shown in Box 10. If the only amount shown in Box 10 is your salary, then your employer already made the necessary adjustment to your income and you should disregard this notice. If you are not certain whether a reimbursement or other expense allowance has been included in Box 10 or whether all per diem and mileage reimbursements and allowances were included, you should check with your employer to determine whether any such amounts were included, and, if so, the amount that was included.

II. *You are not eligible for this adjustment if your reimbursement or expense allowance arrangement is not an "accountable" plan.*

a. *How do I know whether my reimbursement or expense allowance arrangement is an "accountable" plan?* A plan is accountable if: 1) it provides reimbursements for business expenses paid by you in connection with the performance of services for your employer; 2) it requires you to substantiate each business expense to your employer; and 3) it requires you to return to your employer any amount in excess of the substantiated expenses. Special rules for per diem and mileage allowance plans are described below. If a plan fails any of these three requirements, the reimbursement or allowance is included in your income, and the expense does not qualify for an above-the-line deduction. Expenses incurred under a nonaccountable plan are deductible only as a miscellaneous itemized deduction. See Publication 17 for further instructions on the proper treatment of miscellaneous itemized deductions.

b. *What is a per diem or mileage allowance plan?* A per diem plan is a plan under which your business travel expenses for lodging, meals, and/or incidental items are reimbursed at a specified rate based on the period you were away from home (e.g., the number of days traveled) and you are not required to account for the actual amount of your expenses. A mileage allowance plan is a plan under which your automobile transportation expenses are reimbursed at a specified rate per mile.

c. *What special rules apply to per diem and mileage allowance plans?*

1) *Substantiation.* If you have actually provided substantiation to your employer of the time, place and business purpose of the travel reimbursed under a per diem or mileage allowance plan, you are treated as having substantiated an amount equal to the lesser of the amount of the reimbursement you received from your employer or the amount specified by the Internal Revenue Service for the days or miles you traveled whether or not you substantiate the actual dollar amount of your expenses to your employer. In the case of a per diem plan, the amount specified by the Internal Revenue Service is either the Federal per diem rate or the high-low rate. In the case of a mileage allowance, the amount specified by the Internal Revenue Service is the standard mileage rate. These Internal Revenue Service specified rates are described in paragraph III(b) below.

2) *Return of Excess.* A per diem or mileage allowance plan satisfies the return of excess requirement, even if the allowance exceeds the amount treated as substantiated, provided the allowance is reasonably calculated not to exceed your anticipated expenses and you are required to return any portion of such an allowance which relates to days or miles that you did not in fact travel.

d. *What should I do if I do not know whether my plan is an accountable plan?* If you are not certain whether your reimbursement or expense allowance plan is accountable or nonaccountable, you should ask your employer.

III. *If I qualify for an above-the-line deduction, what is the amount of my deduction?*

a. *In general.* The amount you may deduct above-the-line is the *lesser of* the reimbursement you received from your employer or the amount specified by the Internal Revenue Service for the days or miles traveled.

b. *Internal Revenue Service-specified rates.* In computing your above-the-line deduction you may use any of the applicable Internal Revenue Service-specified rates, so long as you have the information (such as cities visited) to support the method. You may use only one per diem method for reimbursements paid by a particular employer in determining your deduction. The Internal Revenue Service-specified per diem and mileage rates are as follows:

1. *Per diem reimbursement for lodging, meals and incidentals.*

A) *Federal per diem rate.* The Federal per diem rate equals the sum of the Federal lodging expense rate and the Federal meal and incidental expense rate for the locality of travel for the period you are away from home. See Revenue Procedure 89-67, section 3.02, 1989-2 C.B. 795, for information regarding these rates. For 1989 only, if you do not have detailed records available to reconstruct and identify all the different localities to which you traveled, or you would have difficulty reconstructing these records, you may use the appropriate Federal per diem rate for travel for which you have records on location and $66 a day for travel to locations for which you do not have records. Alternatively, you may wish to choose the simplified approach under the high-low rate method discussed in paragraph B.

B) *High-low rate.* The "high-low" rate is $122 per day for any "high-cost locality" and $85 per day for any "low-cost locality" to which you traveled. For high-cost localities the lodging amount is $88 and the meals amount is $34. For low-cost localities the lodging amount is $59 and the meals amount is $26. For 1989 only, if you do not have detailed records available to reconstruct and identify all the different localities to which you traveled on business for your employer or you have difficulty reconstructing these records, you may use the $85 low-cost locality rate per day for any day of travel for which you do not have records of the location to which you traveled.

2. *Per diem reimbursement for meals and incidentals only.*

Federal meal and incidental (M&IE) rate. The Federal M&IE rate

for the locality of travel (either $34 or $26 per day) for the period you were away from home. See Revenue Procedure 89-67, section 3.02, 1989-2 C.B. 795, for information on these rates. For 1989 only, if you do not have detailed records available to reconstruct and identify all the different localities to which you traveled on business for your employer or you have difficulty reconstructing these records, you may use the $26 locality rate per day for any day of travel for which you do not have records of the location to which you traveled.

3. *Mileage allowances.* The standard mileage rates for 1989 is 25.5 cents per mile.

IV. *How do I deduct qualified amounts for 1989?*

a. *In general.* If you had amounts included on your form W-2 that were not required to be reported, the following instructions must be followed for 1989 because the Form 1040 no longer provides a specific line to deduct reimbursed employee business expenses above-the-line. To claim an above-the-line adjustment you must file Form 1040 and not Forms 1040A or 1040EZ.

b. *Special instructions for Form 1040.* Determine the lesser of the amount of your business travel expenses under the rules described in paragraph III, that is the amount computed using the Internal Revenue Service specified rate that you have selected or the amount actually reimbursed and reported in box 10 of your Form W-2. Write this amount and the words "Reimbursed Expenses" or "RE" in the dotted area to the left of the column on line 30 of the Form 1040. Include this amount in the total on line 30 (total adjustments to income) of Form 1040. These are the only employee business expenses that you may deduct above-the-line for 1989.

The following examples illustrate the application of these rules to amounts received under *accountable* reimbursement or expense allowance plans.

Example 1: Per Diem Reimbursements Are Less Than Internal Revenue Service-Specified Rates. Employee A incurred travel expenses on a three day business trip to Rock Island, Illinois for her employer. The employer reimbursed employee A under a per diem allowance arrangement at the rate of $80 per day. The employer included the total of these travel allowances ($80 × 3 = $240) in box 10 of employee A's Form W-2. To claim an above-the-line deduction employee A should file Form 1040. Since this was a per diem allowance arrangement, A may calculate the amount of expenses using the Federal per diem rate of $76 per day or the high-low rate of $85 per day. Employee A chooses the high-low $85 per day rate. The lesser of: a) the amount of the per diem allowance that was reported in box 10 of her Form W2 ($240), and b) the amount of the business travel expense calculated under the method chosen by employee A ($85 × 3 = $255) is $240. Employee A writes this amount ("$240") and the words "Reimbursed Expenses" or "RE" in the dotted area to the left of the column on line 30 of the Form 1040. Employee A includes this amount in the total on line 30 (total adjustments to income) of Form 1040.

Example 2: Per Diem Reimbursements Are More Than Internal Revenue Service-Specified Rates. Employee B incurred travel expenses on several business trips for her employer covering a total of 20 days. The employer reimbursed employee B under a per diem allowance arrangement at the rate of $150 per day, and the employee did not retain records to substantiate actual expenses. The employer included the total of these travel allowances ($150 × 20 = $3000) in box 10 of employee B's Form W-2. To claim an above-the-line deduction employee B should file Form 1040. Because employee B does not have records of the localities to which she traveled she chooses to use the high-low rate and applies the special $85 per day rate. The lesser of: a) the amount of the per diem allowance that was reported in box 10 of her Form W-2 ($3000), and b) the amount of the business travel expense calculated under the method chosen by employee B ($85 × 20 = $1700) is $1700. Employee B writes this amount ("$1700") and the words "Reimbursed Expenses" or "RE" in the dotted area to the left of the column on line 30 of the Form 1040. Employee B includes this amount in the total on line 30 (total adjustments to income) of Form 1040. Because B does not have adequate records to substantiate actual expenses in excess of $1700, she may not claim any additional deduction on Schedule A.

Example 3: Mileage Reimbursements Exceed the Standard Mileage Rate. Employee C used his personal automobile to drive 10,000 miles for business purposes in 1989. C's employer reimbursed C at the rate of 30 cents per mile for each business mile driven for a total of $3,000 (.30 × 10,000). The employer included the total automobile expense reimbursement ($3,000) in box 10 of employee C's Form W-2. To claim an above-the-line deduction employee C should file Form 1040. The lesser of: a) the amount of mileage allowance that was reported in box 10 of his Form W-2 ($3,000), or b) the amount computed using the standard mileage rate (.255 × 10,000 = $2,550) is $2,550. Employee C writes this amount ("$2,550") and the words "Reimbursed Expenses" or "RE" in the dotted area to the left of the column on line 30 of the Form 1040. Employee C includes this amount in the total on line 30 (total adjustments to income) of Form 1040. If C has adequate records to substantiate actual expenses in excess of $2,550, he may claim an additional deduction on Schedule A.

High-Cost Locality Table

High Cost Localities. The following localities are high-cost localities. All others are low-cost localities.

Key City	*County and other defined location*
California	
Death Valley	Inyo
Los Angeles	Los Angeles, Kern, Orange, and Ventura Counties, Edwards Air Force Base, Naval Weapons Center and Ordnance Test Station, China Lake
Palm Springs	Riverside
San Francisco	San Francisco
Santa Barbara	Santa Barbara
Colorado	
Aspen	Pitkin
Vail	Eagle
District of Columbia	
Washington, D.C.	The cities of Alexandria, Falls Church, and Fairfax, and the counties of Arlington, Loudoun, and Fairfax in Virginia; and the counties of Montgomery and Prince Georges in Maryland.
Georgia	
Atlanta	Clayton, De Kalb, Fulton, and Cobb
Illinois	
Chicago	Du Page, Cook, and Lake
Maryland	
Annapolis	Anne Arundel
Columbia	Howard
Ocean City	Worcester
Massachusetts	
Andover	Essex
Boston	Middlesex, Norfolk, and Suffolk
Martha's Vineyard/ Nantucket	Dukes and Nantucket
Plymouth	Plymouth
New Hampshire	
Conway	Carroll
New Jersey	
Atlantic City	Atlantic
Newark	Bergen, Essex, Hudson, Passaic, and Union
Ocean City/Cape May	Cape May
Princeton/Trenton	Mercer
New York	
New York City	The boroughs of Bronx, Brooklyn, Manhattan, Queens, and Staten Island; Nassau and Suffolk Counties
White Plains	Westchester
Pennsylvania	
Philadelphia	Philadelphia; city of Bala Cynwyd in Montgomery County
Rhode Island	
Newport	Newport
South Carolina	
Hilton Head	Beaufort
Texas	
Dallas/Fort Worth	Dallas and Tarrant

ADDITIONAL INFORMATION

For additional information on reimbursement and expense allowance arrangements see Revenue Procedures 89-66 and 89-67, 1989-2 C.B. 792, 795, and section 1.62-2T of the temporary regulations published in the Federal Register on December 12, 1989 (54 FR 51021).

RELIANCE

This document serves as an "administrative pronouncement" as that term is described in section 6662(d)(2)(B)(i) of the Internal Revenue Code, and may be relied upon to the same extent as a revenue ruling or revenue procedure. However, this notice is not applicable to any year after 1989.

Magnetic Media Reporting—Information Returns

Notice 90-15

This notice provides guidance with respect to the changes made by section 7713 of the Revenue Reconciliation Act of 1989 (the "Act"), Pub. L. No. 101-239 (1989), 103 Stat. 2106, to the magnetic media reporting requirements for information returns. The legislative history of the Act points out that uniform magnetic media requirements will now apply to all information returns filed for a calendar year. The new rules apply to information returns due after December 31, 1989.

Section 6011(e)(2)(A) of the Code now provides that the Secretary shall not prescribe regulations requiring a person to file returns on magnetic media unless such person is required to file at least 250 returns during the calendar year. Therefore, the 250 threshold that previously applied by regulations to most types of information returns now applies to all information returns.

The special rules, under prior law, for information returns reporting interest, original issue discount, dividends, and patronage dividends have been repealed. Under prior law, a person required to file a total of more than 50 returns on Forms 1099-INT, 1099-OID, 1099-DIV, and 1099-PATR, was required to file on magnetic media. For purposes of determining the number of returns that a person was required to file on magnetic media, all such returns had to be aggregated. In addition, under prior rules, all Forms 1099-B were required to be filed on magnetic media.

Under the new law, all information returns, including those required on Forms 1099-B, 1099-INT, 1099-OID, 1099-DIV, and 1099-PATR, may be filed on the prescribed paper form if fewer than 250 returns are required to be filed. The 250 threshold applies separately to each type of form. Thus, for example, if a person is required to file 200 returns on Form 1099-INT and 350 returns on Form 1099-MISC for a calendar year, the person is not required to file Forms 1099-INT on magnetic media, but is required to file Forms 1099-MISC on magnetic media. Magnetic media filing requirements for the preceding year will no longer be determinative of a person's obligation to file on magnetic media. (See section 301.6011-2(c)(1) and (2) of the Regulations on Procedure and Administration for the rules that applied before the effective date of the Act's amendments to section 6011(e).)

The 250 threshold applies separately to both original and corrected returns. Thus, for example, if a person files 300 returns on Form 1099-DIV and later files 70 corrected returns on Form 1099-DIV, the corrected returns may be filed on the prescribed paper form since they fall under the 250 threshold.

These uniform magnetic media filing requirements apply to the following forms:

- Form W-2, Wage and Tax Statement;
- Form W-2P, Statement for Recipients of Aannuities, Pensions, Retired Pay, or IRA Payments;
- Form W-2G, Statement for Recipients of Certain Gambling Winnings;
- Form 1099 series, Information Returns;
- Form 1098, Mortgage Interest Statement;
- Form 1042S, Foreign Person's U.S. Source Income Subject to Withholding;
- Form 5498, Individual Retirement Arrangement Information; and
- Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips.

PROCEDURAL INFORMATION

This notice constitutes authority within the meaning of section 6662(d)(2)(B)(i) of the Code and may be relied upon to the same extent as a revenue ruling or a revenue procedure.

List of Countries Requiring Cooperation With an International Boycott

Notice 90-16

In order to comply with the mandate of section 999(a)(3) of the Internal Revenue Code of 1954, the Department of the Treasury is publishing a current list of countries which may require participation in, or cooperation with, an international boycott (within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954). The list is the same as the prior quarterly list published in the Federal Register.

On the basis of the best information currently available to the Department of the Treasury, the following countries may require participation in, or cooperation with, an international boycott (within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954).

Bahrain
Iraq
Jordan
Kuwait
Lebanon
Libya
Oman
Qatar
Saudia Arabia
Syria
United Arab Emirates
Yeman, Arab Republic
Yemen, Peoples Democratic Republic of

Dated: January 17, 1990

Kenneth W. Gideon,
Assistant Secretary for Tax Policy.

(Filed by the Office of the Federal Register on January 22, 1990, 8:45 a.m., and published in the issue of the Federal Register for January 23, 1990, 55 F.R. 2278)

Cost-of-Living Adjustments—Defined Benefit Pension Plans

Notice 90-17[1]

The cost-of-living adjustments applicable to dollar limitations on benefits under qualified defined benefit pension plans and to other provisions affecting such plans are set forth.

Section 415 of the Internal Revenue Code provides for dollar limitations on benefits and contributions under these plans. It also requires that the Commissioner annually adjust these limits for cost-of-living increases. Effective Jan. 1, 1990, the maximum limitation for the annual benefit under section 415(b)(1)(A) for defined benefit plans is increased from $98,064 to $102,582.

The limitation for defined contribution plans under section 415(c)(1)(A) remains at $30,000 for 1990 since the law provides that it shall not be changed until the section 415(b)(1)(A) limit for benefits exceeds $120,000.

The Code provides that various other dollar amounts are to be adjusted at the same time and in the same manner as the dollar limitation of section 415(b)(1)(A) is adjusted. These dollar amounts and the adjusted amounts are as follows:

The special limitation for qualified police or firefighters under section 415(b)(2)(G) is increased from $54,480 to $56,990.

The limitation on the exclusion for elective deferrals under section 402(g)(1) is increased from $7,627 to $7,979.

The dollar amounts under 409(0)(1)(C)(ii) for lengthening the distribution period of that section for tax credit employee stock ownership plans are increased from $108,960 to $113,980 and from $544,800 to $569,900.

The threshold amount under section 4980A(c)(1) regarding excess distributions is increased from $122,580 to $128,228.

The limitations used in the definition of highly compensated employee under section 414(q) of the $81,720 and $54,480 are respectively increased to $85,485 and $56,990.

The annual compensation limit under sections 401(a)(17) and 404(1) of the Code is increased from $200,000 to $209,200.

The compensation amount under section 408(k)(2)(C) regarding simplified employee pension plans (SEPs) is increased from $327 to $342. The compensation amount under section 408(k)(3)(C) is increased from $200,000 to $209,200.

Administrators of defined benefit or defined contribution plans that have received favorable determination letters should not request new determination letters solely because of yearly amendments to adjust maximum limitations in the plans.

Form 990-T Filing for Multiple IRA Trusts

Notice 90-18

This Notice provides a method under which trustees of Individual Retirement Accounts (IRAs) that have invested in regulated investment companies (RICs) may file a composite return for such IRAs to claim a refund under section 852(b) of the Internal Revenue Code.

An IRA that has invested in a RIC that has elected to retain a long term capital gain must file a Form 990-T, Exempt Organization Business Income Tax Return, to claim a refund of its share of tax paid by the RIC under section 852(b) of the Code. Prior to this Notice, a single entity that served as a common trustee for several such IRAs was required to prepare a separate Form 990-T for each IRA.

In lieu of filing a separate Form 990-T for each IRA, a common trustee of more than one IRA entitled to refunds under section 852(b) may now file a single composite Form 990-T for all such IRAs. This composite filing is accomplished as follows.

1. The trustee must apply to its Internal Revenue Service Center for a special employer identification number on Form SS-4, Application for Employer Identification Number. The trustee must indicate that the application is for a Special Employer Identification Number (EIN) by writing "Notice 90-18" on the top of the Form SS-4. The special EIN will be effective only for making a composite claim for refund of tax under section 852(b) of the Code on behalf of the IRAs administered by the trustee. The trustee should not apply for a separate specialized EIN for each year it makes a claim for refund.

2. The trustee will file one composite return on Form 990-T for each year it makes a claim. It must attach a list of the IRAs for which the claim is being made showing the names and social security numbers of the persons who established the IRAs and the allocated shares of tax paid by the RICs. The IRAs must be grouped according to the RIC in which it has made an investment. Form 2439 must be attached for each RIC according to such grouping.

3. The trustee must write on the top of the Form 990-T "Composite Return per Notice 90-18." It must enter the special EIN assigned for the composite return (and only that EIN) in the block provided for EINs.

4. The Service will issue one refund check to the IRA trustee. The trustee must allocate the refund to the IRA trusts in accordance with the amounts due as shown on the composite return.

A composite return is not available in the following circumstances:

(1) A composite return may only be filed by a common trustee of more than one IRA. It cannot be filed by a person acting merely as a nominee (owner of record) of RIC shares owned by an IRA.

(2) An IRA that has unrelated business taxable income may not be included in the claim for refund on the composite return. The trustee of such an IRA must file a separate Form 990-T for the IRA reporting the income on such return and claiming credit under section 852(b) as an offset against the IRA's unrelated business income tax liability.

The 1990 Form 990-T and its instructions will be revised to reflect the composite filing method of this Notice.

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[1] Based on News Release IR-90-15, dated January 30, 1990.

Extension of the March 10, 1990, Reporting Deadline in Temp. Reg. 301.6114-1T(e)

Notice 90-19

Section 301.6114-1T contains temporary regulations pertaining to section 6114 of the Code (T.D. 8262, 1989-2 C.B. 253). Section 301.6114-1T(e) provides that section 301.6114-1T shall be effective for taxable years of the taxpayer for which the due date for filing returns (without extensions) occurs after December 31, 1988. However, in certain transitional circumstances, the taxpayer may have until March 10, 1990, to file the statement required by section 301.6114-1T(d).

This notice extends that March 10, 1990, date by which the statement required by section 301.6114-1T(d) must be filed until the date that is 90 days after the date of the publication of the final regulation in the Federal Register. That final regulation has not yet been published. The reporting requirement imposed by section 301.6114-1T(a) with respect to all other returns due on or before March 10, 1990, is likewise extended to such date.

This document serves as an "administrative pronouncement" as that term is used in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

EFFECT ON OTHER DOCUMENTS

Section 301.6114-1T(e) is modified.

Accuracy-Related Penalty Income Tax Return Preparer Penalty

Notice 90-20

I. PURPOSE

This notice provides guidance with respect to the portions of the accuracy-related penalty imposed under sections 6662(b)(1) and (2) of the Internal Revenue Code on underpayments of tax attributable to negligence or disregard of rules or regulations and to substantial understatements of income tax. To the limited extent indicated in section V(A) of this notice (which deals with the "substantial authority" test under the penalty for substantial understatements of income tax), the notice also provides rules which are effective under section 6661 of prior law. In addition, this notice provides guidance with respect to the penalties imposed under section 6694 of the Code for any understatement of a taxpayer's tax liability caused by an income tax return preparer on any return or claim for refund.

II. BACKGROUND

Subtitle G (sections 7701-7743) of the Revenue Reconciliation Act of 1989 (the "Act"), Pub. L. No. 101-239, 103 Stat. 2106, has substantially revised the civil tax penalty provisions of the Internal Revenue Code. In particular, section 7721 of the Act, among other things, has modified the rules that formerly were contained in section 6653 of the Code (which included the negligence and fraud penalties), section 6659 (the valuation overstatement penalty), section 6659A (the penalty for overstatement of pension liabilities), section 6660 (the estate and gift tax valuation understatement penalty), and section 6661 (the substantial understatement penalty). Penalties similar to those formerly imposed under sections 6653(a) and (b), 6659, 6659A, 6660, and 6661 are contained in new sections 6662 and 6663. New sections 6664 and 6665 contain definitions and other rules applicable with respect to these penalties.

New section 6662 of the Code imposes a penalty (the "accuracy-related penalty") equal to 20 percent (40 percent, in the case of a gross valuation misstatement) of the portion of an underpayment of tax that is attributable to one or more of the following: (1) negligence or disregard of rules or regulations; (2) any substantial understatement of income tax; (3) any substantial valuation overstatement under chapter 1 of the Code; (4) any substantial overstatement of pension liabilities; and (5) any substantial estate or gift tax valuation understatement. New section 6664(c) provides that, subject to special rules for certain valuation overstatements, the penalty provided in section 6662 is not imposed with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.

Section 7732 of the Act has substantially amended paragraphs (a) and (b) of section 6694 of the Code (the "preparer penalties"). In addition, section 7733 of the Act has modified the amounts of the penalties under section 6695 concerning failures by income tax return preparers to take certain required administrative actions.

III. EFFECTIVE DATES

New sections 6662, 6663, 6664, and 6665 of the Code apply to returns the due date for which (determined without regard to extensions) is after December 31, 1989. The amendments to sections 6694 and 6695 apply to documents prepared after December 31, 1989.

The Internal Revenue Service will be issuing regulations and other guidance concerning the changes made by the Act with respect to the accuracy-related penalty and preparer penalties. Until further guidance is issued by the Service, this notice sets forth rules on which taxpayers and preparers may rely with respect to the negligence (sections 6662(b)(1) and (c)) and substantial understatement (sections 6662(b)(2) and (d)) portions of the accuracy-related penalty, and with respect to the preparer penalties. To the extent inconsistent with this notice, any future guidance will have only prospective application.

IV. PENALTY FOR NEGLIGENCE OR DISREGARD OF RULES OR REGULATIONS

The penalty provided in sections 6662(b)(1) and (c) of the Code for underpayments attributable to negligence or disregard of rules or regulations is substantially the same as the penalty provided under former section 6653(a) with two principal modifications. First, the rate of the penalty has been increased from 5 percent to 20 percent. Second, the penalty is

only imposed on the portion of the underpayment attributable to negligence or disregard of rules or regulations rather than on the entire underpayment (as was the case under former section 6653(a)). Under section 6664(c), the penalty provided in sections 6662(b)(1) and (c) will not be imposed with respect to a portion of an underpayment if it is shown that there was reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.

Pursuant to the reasonable cause and good faith exception in section 6664(c) of the Code, the Service will not impose the penalty under sections 6662(b)(1) and (c), relating to negligence or disregard of rules or regulations, with respect to a nonfrivolous position if the taxpayer has made a complete, item- specific disclosure of such nonfrivolous position. Such disclosure must be full and substantive and be clearly identified as being made to avoid imposition of the accuracy-related penalty.

Until further guidance is issued by the Service, the Service will consider disclosure to have been made in accordance with the preceding paragraph if it is made according to the rules set forth in this paragraph. The disclosure must be made on the return or on a properly completed Form 8275, Disclosure Statement Under Section 6661, attached to the return. (Taxpayers may use Form 8275 even though the form was designed for disclosure under former section 6661 and refers to that section.) If the disclosure is made on the return (rather than on Form 8275) the disclosure must contain the caption, "DISCLOSURE MADE UNDER SECTION 6662". The caption must appear at the top left-hand corner of the return (for example, above the title "1040 U.S. Individual Income Tax Return 1989" in the case of Form 1040) and clearly refer to the page or line number containing the disclosure. For example, a taxpayer wishing to avoid the imposition of the penalty under sections 6662(b)(1) and (c) with respect to the deduction of certain medical expenses would write in the top left-hand corner of the first page of Form 1040, "DISCLOSURE MADE UNDER SECTION 6662. SEE LINES 1-4 OF SCHEDULE A" and then describe on Schedule A the additional information necessary to make full disclosure. (Taxpayers should not write in the upper right-hand corner of the return—on Form 1040, this is the area to the right of the numerals "1989"—because this area is used in IRS processing.)

In no event will completing and filling in a tax form or line item in accordance with applicable forms and instructions be considered sufficient disclosure, in itself, for purposes of avoiding the penalty under sections 6662(b)(1) and (c) for negligence or disregard of rules or regulations. Thus, disclosure for purposes of sections 6662(b)(2) and (d), relating to the penalty for substantial understatement of income tax, that is made in accordance with Rev. Proc. 90-16, published concurrently with this notice, will not be sufficient to avoid the imposition of the penalty provided in sections 6662(b)(1) and (c). In addition, disclosure is not effective to avoid the imposition of the penalty under sections 6662(b)(1) and (c) for negligence or disregard of rules or regulations where the penalty is imposed because the taxpayer failed to keep proper books and records or to substantiate items properly. In no event will disclosure avoid the imposition of this penalty with respect to a position that is frivolous.

V. PENALTY FOR SUBSTANTIAL UNDERSTATEMENT OF INCOME TAX

The penalty provided in sections 6662(b)(2) and (d) of the Code for a substantial understatement of income tax is substantially the same as the penalty provided under former section 6661 with three principal modifications. First, the rate of the penalty has been decreased from 25 percent to 20 percent. Second, as explained in more detail below, the definition of the term "authority" has been expanded to include additional items. Third, under section 6662(d)(2)(D), the Service is required to publish (solely as an informational aid to taxpayers) an annual list of positions for which it believes there is not "substantial authority" and which affect a significant number of taxpayers.

Sections 6662(b)(2) and (d) of the Code provide that a penalty is imposed on the portion of an underpayment on a return that is attributable to a "substantial understatement of income tax." Section 6662(d)(1) provides that an understatement is substantial if it exceeds the greater of 10 percent of the amount of tax required to be shown on the return or $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). Section 6662(d)(2) provides that for purposes of applying this penalty, the amount of any understatement is reduced by that portion of the understatement which is attributable to (1) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment, or (2) any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return. Special rules apply in the case of a tax shelter (as defined in section 6662(d)(2)(C)).

(A). *Substantial Authority*

For purposes of the "substantial authority" test under section 6662(d)(2)(B)(i), as under former section 6661, authority includes the following: applicable provisions of the Internal Revenue Code and other statutory provisions; temporary and final regulations construing such statutes; court cases; administrative pronouncements (including revenue rulings and revenue procedures); tax treaties and regulations thereunder, and Treasury Department and other official explanations of such treaties; and congressional intent as reflected in committee reports, joint explanatory statements of managers included in conference committee reports, and floor statements made prior to enactment by one of the bill's managers.

For purposes of section 6662(d)(2)(B)(i) of the Code, the Service also will treat as authority General Explanations of tax legislation prepared by the Joint Committee on Taxation (the "Blue Book"), proposed regulations, information or press releases, notices, announcements, and any other similar documents published by the Service in the Internal Revenue Bulletin. In addition, for purposes of section 6662(d)(2)(B)(i), the Service will treat as authority private letter rulings, technical advice memoranda, actions on decisions, and general counsel

memoranda after they have been released to the public and provided they are dated after December 31, 1984 (the date that is five years prior to the general effective date of the penalty provisions of the Act). The Service is considering whether regulations should provide rules under which, on a continuing basis, private letter rulings, technical advice memoranda, actions on decisions, and general counsel memoranda issued prior to a specified date (for example, more than a specified number of years before the date on which a tax return is due) would be considered outdated and would no longer constitute authority with respect to items on a return. The Service requests comments with respect to this question.

As under former section 6661, "authority" does not include conclusions reached in treatises, legal periodicals, and opinions rendered by tax professionals.

With respect to returns that were due (without regard to extensions) on or before December 31, 1989, the Service will apply section 6661(b)-(2)(B)(i) of prior law using the definition of authority provided, for purposes of section 6662(d)(2)(B)(i), in this notice.

In determining whether the authority supporting treatment of an item is substantial under section 6662(d)-(2)(B)(i) of the Code, the Service will continue to apply the principles of section 1.6661-3 of the Income Tax Regulations, except to the extent that section 1.6661-3 is inconsistent with the listing of authorities set forth in this notice. Thus, there is substantial authority for the tax treatment of an item only if the weight of authorities supporting such tax treatment is substantial in relation to the weight of authorities supporting contrary tax treatments. The weight to be accorded an authority is affected by the type of document providing the authority. For example, a revenue ruling addressing a question generally will have greater weight than a private letter ruling addressing the same question. Also, the weight of an authority from which information has been deleted, such as a private letter ruling, is further diminished to the extent that such deleted information may have affected the conclusions reached therein. For example, a private letter ruling holding that a particular amount is de minimis for purposes of section 368 of the Code will be given little or no weight with respect to the question of what is a de minimis amount if the amount on which the holding relies has been deleted from the private letter ruling as released to the public.

(B). *Adequate Disclosure*

Under section 6662(d)(2)(B)(ii) of the Code, except in the case of a tax shelter, the amount of an understatement is reduced by that portion of the understatement that is adequately disclosed in the return or in a statement attached to the return.

Until further guidance is issued by the Service, for purposes of determining what constitutes adequate disclosure under section 6662(d)(2)(B)(ii) of the Code, the rules that have been applicable under former section 6661 shall apply. Thus, for example, if the taxpayer's disclosure of an item would be considered adequate under either section 1.6661-4 of the regulations or Rev. Proc. 85-26, 1985-1 C.B. 580 (concerning taxpayers subject to the Service's Coordinated Examination Program), such disclosure will be considered adequate for purposes of section 6662(d). Until the issuance of further guidance by the Service, a properly completed Form 8275 as currently available will also constitute adequate disclosure with respect to an item for purposes of section 6662(d)(2)(B)(ii), notwithstanding that the form refers to former section 6661 of the Code.

Rev. Proc. 90-16, published concurrently with this notice and updating Rev. Proc. 89-11, 1989-1 C.B. 797, identifies circumstances under which the completion of certain forms and schedules in an income tax return can constitute adequate disclosure for purposes of reducing the understatement of income tax under section 6662(d) of the Code.

Taxpayers should note that, in some circumstances, disclosure adequate to avoid the penalty under sections 6662(b)(2) and (d) of the Code for substantial understatement of income tax (such as disclosures made pursuant to Rev. Proc. 90-16) will not suffice to avoid imposition of the penalty under sections 6662(b)(1) and (c) for negligence or disregard of rules or regulations. However, a disclosure sufficient to avoid the penalty under sections 6662(b)(1) and (c) for negligence or disregard of rules or regulations, as described in Section IV of this notice, will also constitute adequate disclosure for purposes of the penalty under sections 6662(b)(2) and (d) for substantial understatement of income tax. Therefore, taxpayers wishing to make a single disclosure that is effective for both of these portions of the accuracy-related penalty (subject to the limitations described in Section IV) should follow the procedures for making sufficient disclosure set forth in Section IV.

VI. PENALTY FOR UNDERSTATEMENT OF A TAXPAYER'S TAX LIABILITY ON A RETURN OR CLAIM FOR REFUND CAUSED BY AN INCOME TAX RETURN PREPARER

Section 7732 of the Act has substantially amended the preparer penalties contained in sections 6694(a) and (b) of the Code.

Under section 6694(a) of the Code, as amended by the Act, if (1) any part of any understatement of liability with respect to any income tax return or claim for refund is due to a position for which there was not a realistic possibility of being sustained on its merits, (2) any person who is an income tax return preparer with respect to such return or claim knew (or reasonably should have known) of such position, and (3) such position was not disclosed (as provided in section 6662(d)(2)(B)(ii)) or was frivolous, such person shall pay a penalty of $250 with respect to such return or claim unless it is shown that there is reasonable cause for the understatement and such person acted in good faith.

The new "realistic possibility of being sustained on its merits" standard under section 6694(a) of the Code is a stricter standard than that of section 6694(a) prior to revision by the Act. The new standard does not, however, require certainty, nor does it require a preparer to conclude that the position is more likely than not to succeed. For example, the Service will treat a position as having a realistic possibility of being sustained on its merits if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead

such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits.

Negligent behavior that would have been subject to the penalty under former section 6694 of the Code will continue to be subject to the penalty as amended by the Act. Until the release of further guidance by the Service, the preparer's duty of inquiry into factual matters will remain the same as under prior law. For example, a failure by a preparer to make reasonable inquiries if the information furnished to the preparer appears to be incorrect or incomplete can support imposition of the amended penalty, just as it could have supported imposition of the penalty under prior law. *See* Rev. Proc. 80-40, 1980-2 C.B. 774.

Under section 6694(b) of the Code, as amended by the Act, if any part of any understatement of liability with respect to any return or claim for refund is due (1) to a willful attempt in any manner to understate the liability for tax by a person who is an income tax return preparer with respect to such return or claim, or (2) to any reckless or intentional disregard of rules or regulations by any such person, the return preparer shall pay a penalty of $1,000 with respect to such return or claim. As under prior law, with respect to any return or claim for refund, the amount of any penalty payable by a person under section 6694(b) is reduced by the amount of any penalty paid by such person under section 6694(a).

With respect to nonfrivolous positions, the penalties provided in sections 6694(a) and (b) of the Code will not be imposed if such position is sufficiently disclosed on the return or claim for refund. For purposes of section 6694(a), disclosure is sufficient if it constitutes adequate disclosure for purposes of section 6662(d), as described in Section V(B) of this notice. Thus, if an item is disclosed as provided in Rev. Proc. 90-16, or otherwise meets the requirements of Section V(B) of this notice, no penalty will be imposed under section 6694(a) unless such position is frivolous. However, for purposes of section 6694(b), disclosure is sufficient only if it meets the requirements for waiver, on the basis of sufficient disclosure, of the penalty under sections 6662(b)(1) and (c) for negligence or disregard of rules or regulations. These requirements are described in Section IV of this notice.

Because the penalties under both sections 6694(a) and (b) of the Code may be imposed with respect to a single position on the return, income tax return preparers may wish to make a single disclosure statement to avoid the imposition of both penalties. In order to afford protection against the penalties under both sections 6694(a) and (b), a preparer must make disclosure of the kind required for waiver, on the basis of sufficient disclosure, of the penalty under sections 6662(b)(1) and (c) for negligence or disregard of rules or regulations, as described in Section IV of this notice.

If there is more than one income tax return preparer with respect to a return or claim for refund, the preparer who, under section 1.6695-1(b) of the regulations, is required to sign such return or claim is the preparer who is responsible for making the disclosure statement to avoid imposition of the penalties under sections 6694(a) and (b) of the Code. A person may be an income tax return preparer by reason of having furnished information or advice with respect to a substantial portion of a return or claim for refund, but may nevertheless not be the person required to sign the return or claim. *See* sections 6695 and 7701(a)(36) of the Code and the regulations thereunder. The Service is considering the degree to which such a person has an obligation to advise either the taxpayer filing the return or claim, or the preparer who is required to sign the return or claim, of disclosures that might be necessary in order to avoid the imposition of penalties. The Service invites comments on rules that may be appropriate with respect to the application of the preparer penalties to an income tax return preparer who was not required to sign a return or claim for refund, including ways by which such a person may avoid imposition of the penalties.

Until the release of further guidance, the Service will not assert the preparer penalties, with respect to a return or claim for refund, prepared after December 31, 1989, against a preparer who is not required to sign the return. Nonsigning preparers are reminded, however, that as was true under prior law, they may be subject to other penalties (such as the penalty for aiding and abetting understatements of tax liability under section 6701 of the Code) for knowingly or recklessly assisting others to understate their tax liabilities.

VII. PROCEDURAL INFORMATION

In the past, notices and announcements issued by the Service, which did not, by reason of the regulations under former section 6661, necessarily constitute authority for purposes of the substantial understatement penalty, contained a special statement if the Service intended for taxpayers to rely on them as authority. See Rev. Rul. 87-138, 1987-2 C.B. 287. The Service hereby announces that, in keeping with section V(A) of this notice, all notices and announcements issued by the Service and published in the Internal Revenue Bulletin will constitute authority for purposes of the substantial understatement portion of the accuracy-related penalty, and may be relied upon to the same extent as revenue rulings or revenue procedures. Accordingly, such documents issued after March 5, 1990, the date of publication of this notice, generally will not contain a statement indicating the extent to which they can be relied upon.

VIII. REQUEST FOR COMMENTS

The Service requests comments on the matters addressed in this notice. In particular, the Service requests comments on (i) items to be included in the annual list of taxpayer positions for which the Service believes there is not "substantial authority," which list is required to be published under section 6662(d)(2)(D) of the Code; (ii) whether regulations should specify that, on a continuing basis, private letter rulings, technical advice memoranda, actions on decisions, and general counsel memoranda issued more than a specified number of years in the past should be considered outdated and not useful as authority for purposes of section 6662(d)-(2)(B)(i); and (iii) the preparer penalties, particularly with respect to the waiver for adequate disclosure as it may apply to an income tax return preparer who is not required to sign a

return or claim for refund. Comments may be addressed to the Associate Chief Counsel (Technical), Internal Revenue Service, 1111 Constitution Ave. N.W., Room 3527, Washington, D.C. 20224. Comments should be received by April 10, 1990, in order to ensure that they will receive full consideration.

Treatment of Casualty and Theft Losses under Sections 165, 280B, and 469

Notice 90-21

I. PURPOSE OF NOTICE

Recent natural disasters have raised questions about how sections 165 and 469 of the Internal Revenue Code apply to casualty losses. Section 165 allows certain losses, including casualty losses, but section 469 disallows losses from passive activities. This notice answers those questions and explains how the capitalization requirements of section 280B apply when structures are demolished following casualties.

II. BACKGROUND

A. *Section 165 generally*

Section 165(a) of the Code allows a deduction for certain losses sustained during the taxable year and not compensated for by insurance or otherwise. Section 1.165-1(a) of the Income Tax Regulations subjects this allowance to any provision of the internal revenue laws that prohibits or limits the amount of the deduction.

Section 165(c) of the Code limits an individual's deduction under section 165 to:

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and

(3) except as provided in section 165(h), losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft.

Section 165(c)(3) thus allows losses from thefts and certain casualties that are not incurred in a trade or business or in a transaction entered into for profit ("personal casualty losses").

Unless section 165(i) of the Code applies, a loss is allowed as a deduction under section 165(a) only for the taxable year in which the loss is sustained. If a claim for reimbursement of a loss exists (for example, an insurance claim), the loss cannot be deducted under section 165 until there is no longer a reasonable prospect of recovery on the claim. If a taxpayer properly deducts a loss and receives reimbursement in a subsequent taxable year, the taxpayer does not recompute the tax for the taxable year in which the deduction was taken. Instead, the taxpayer generally must include the reimbursement in gross income for the taxable year received. *See* §1.165-1(d)(2) of the regulations.

B. *Amount of loss allowed under section 165*

In general, the amount allowed as a deduction under section 165 for any casualty loss equals the lesser of (i) the amount by which the damaged property's fair market value immediately before the casualty exceeds the property's fair market value immediately after the casualty, or (ii) the damaged property's adjusted basis for determining a loss from a sale or other disposition of the property. However, if a casualty totally destroys property used in a trade or business or held for the production of income, and the property's fair market value immediately before the casualty is less than the property's adjusted basis, the property's adjusted basis is treated as the amount of the loss. *See* section 165(b) of the Code and §1.165-7(b)(1) of the regulations. Under §1.165-8(c), similar rules apply in determining the amount of a theft loss deduction. The amount of the deduction must be reduced by any insurance or other reimbursement received with respect to the property.

If a casualty loss is incurred in a trade or business or in a transaction entered into for profit, §1.165-7(b)-(2)(i) of the regulations requires that the loss be determined by reference to the single, identifiable property damaged or destroyed. For example, if a casualty damages or destroys a building and damages the land on which it is located, separate losses must be determined for the building and the land.

C. *Section 469*

Section 469 of the Code disallows the passive activity loss and the passive activity credit for the taxable year of individuals, estates, trusts, and certain types of corporations. Section 1.469-2T(b)(1) of the temporary Income Tax Regulations generally defines the "passive activity loss" as the amount by which the taxpayer's passive activity deductions (within the meaning of §1.469-2T(d)) exceed the taxpayer's passive activity gross income (within the meaning of §1.469-2T(c)) for the taxable year.

Under §1.469-2T(d)(1) of the temporary regulations, a deduction is a passive activity deduction if it arises in connection with the conduct of an activity that is a passive activity for the taxable year or a prior taxable year. In general, an activity is a passive activity for a taxable year if the activity (i) is a trade or business activity (within the meaning of §1.469-1T(e)(2)) in which the taxpayer does not materially participate for the taxable year, or (ii) is a rental activity (within the meaning of §1.469-1T(e)(3)).

By definition, personal casualty losses do not arise in connection with a trade or business activity or a rental activity, and, therefore, do not arise in connection with the conduct of any passive activity. Accordingly, they are not subject to disallowance under section 469 of the Code.

Passive activity deductions do not include the deductions listed in §1.469-2T(d)(2) of the temporary regulations. Until recently, this list did not include deductions for casualty and theft losses. Accordingly, any deduction for a casualty or theft loss that arose in connection with the conduct of a passive activity was subject to disallowance under section 469 of the Code. The amendment of §1.469-2T(d)(2) described in the next section of this notice has changed that result.

III. CHANGE IN TREATMENT OF CASUALTY AND THEFT LOSSES UNDER SECTION 469

A. *Amendments of the regulations*

The Internal Revenue Service has determined that section 469 of the Code should not apply to all casualty and theft losses. Accordingly, the Service has amended §1.469-2T(d)(2) of

the temporary regulations, and §1.469-2T(d)(2)(xi) now provides that certain casualty and theft losses are not passive activity deductions.

This exclusion applies to any deduction for a loss from fire, storm, shipwreck, or other casualty, or from theft, as those terms are used in section 165(c)(3), if losses that are similar in cause and severity do not recur regularly in the conduct of the activity and the taxpayer—

(A) Sustains the loss during a taxable year beginning after December 31, 1989; or

(B) Sustains the loss during a taxable year beginning before January 1, 1990, and treats the deduction as a deduction that is not from a passive activity on the taxpayer's return (or amended return) for such taxable year.

The exclusion applies to all taxpayers subject to section 469. The Service has also amended §1.469-2T(c)(7) of the temporary regulations. Section 1.469-2T(c)(7)(vi) now excludes from passive activity gross income any gross income attributable to the reimbursement of a casualty or theft loss if—

(A) The reimbursement is included in gross income under §1.165-1(d)(2)(iii) (relating to reimbursements of losses that the taxpayer deducted in a prior taxable year); and

(B) The deduction for the loss was not a passive activity deduction.

These amendments of §§1.469-2T(c)(7) and (d)(2) are set forth in Treasury Decision 8290, page 109, this Bulletin,

B. *Scope of amendments*

The new exemption from the section 469 limitations in §1.469-2T(d)-(2)(xi) of the temporary regulations applies only to certain casualty and theft losses. It does not apply to any other current or prior-year deductions, whether from the activity in which the lost or damaged property was used or from any other activity. Similarly, new §1.469-2T(c)(7)(vi) applies only to reimbursements of casualty or theft losses that were not passive activity deductions.

Under section 469(g) of the Code, losses from an activity are allowed without limitation by section 469 if the taxpayer disposes of the taxpayer's entire interest in the activity to an unrelated person in a fully taxable transaction. In general, this rule does not apply unless all the assets used or created in the activity (including land) are disposed of. S. Rep. No. 313, 99th Cong., 2d Sess. 725 (1986), 1986-3 (Vol. 3) C.B. 725. Accordingly, a casualty or theft loss involving property used in an activity does not constitute a complete disposition of the taxpayer's interest in the activity under section 469(g) unless the casualty or theft results in the loss of all property used or created in the activity.

IV. COORDINATION WITH OTHER PROVISIONS

A. *In general*

New §1.469-2T(d)(2)(xi) of the temporary regulations does not change the treatment of a casualty or theft loss incurred in a trade or business or a transaction entered into for profit for purposes other than section 469. For example, if a casualty totally destroys property used in a trade or business or held for the production of income, and the property's fair market value immediately before the casualty is less than the property's adjusted basis, the amount of the loss taken into account under section 165 is the property's adjusted basis (*see* §1.165- 7(b)(1)(ii) of the regulations). Under §1.165-7(b)(2)(i), the loss must be determined by reference to the single, identifiable property damaged or destroyed.

A casualty or theft loss incurred in a passive activity is not a personal casualty loss and thus is not subject to the limitations and other rules in section 165(h) of the Code. It may be treated as a section 1231 loss, subject to the rule in section 1231(a)(4)(C). Under that rule, section 1231(a) does not apply to involuntary conversions of certain property from fire, storm, shipwreck, or other casualty, or from theft, if the recognized losses from such conversions exceed the recognized gains from such conversions.

B. *Section 165(i)*

Under section 165(i) of the Code, a taxpayer may elect to take certain disaster losses into account for the taxable year immediately preceding the taxable year in which the disaster occurred. This rule applies to any loss otherwise deductible under section 165(a) and attributable to a disaster occurring in an area determined by the President of the United States to warrant Federal Government assistance under the Disaster Relief and Emergency Assistance Act. Information about these areas is published in the Internal Revenue Bulletin. *See, e.g.*, Rev. Rul. 90-10, page 42, this Bulletin. Section 1.165-11(e) of the regulations prescribes the time and manner of making the election. Section 165(i) may apply to casualty losses excluded from passive activity deductions under new §1.469-2T(d)-(2)(xi) of the temporary regulations.

If an election is made under section 165(i) of the Code, the casualty resulting in the loss is treated for federal tax purposes as having occurred in the taxable year for which the deduction is claimed. For example, the loss deduction is taken into account in determining the net operating loss (within the meaning of section 172(c)) for such year.

C. *Section 280B*

Section 280B of the Code disallows certain otherwise allowable deductions to owners and lessees of demolished structures. This rule applies to any amount expended for the demolition and any loss sustained on account of the demolition. These amounts must be charged to capital account with respect to the land on which the demolished structure was located.

Section 280B of the Code does not disallow casualty losses allowable under section 165, but it does apply to amounts expended for the demolition of a structure damaged or destroyed by casualty, and to any loss sustained on account of such a demolition. If a casualty damages or destroys a structure, and the structure is then demolished, the basis of the structure must be reduced by the casualty loss allowable under section 165 before the "loss sustained on account of" the demolition is determined.

V. EXAMPLES

The following examples illustrate the application of the amendments of the section 469 regulations and other rules described in this notice:

Example (1)

In 1970, A, a calendar-year taxpayer subject to section 469 (*see* §1.469-1T(b) of the temporary regulations) bought an apartment building for $1,500,000. To determine basis, A properly allocated $1,000,000 of the purchase price to the building and $500,000 to the land. By 1989, the building's fair market value was

$2,000,000; its adjusted basis was $100,000. The land's fair market value was $1,000,000; its adjusted basis was $500,000. A used the property in a rental activity (within the meaning of §1.469-1T(e)(3)) for all taxable years.

In 1989, an earthquake destroyed the building, reducing its fair market value to $0. In addition, the earthquake reduced the land's fair market value to $800,000 by burdening the land with rubble and a useless building. The estimated cost of demolishing the building and removing the rubble was $200,000. The building was not insured against casualties. As of the beginning of 1989, $100,000 of passive activity deductions from the rental activity in which the building and land were used were disallowed under §1.469-1T(f)(2)(ii) of the temporary regulations.

A calculates the casualty loss allowable under section 165 as follows:

Building:

Value of property immediately before casualty	$2,000,000
Less: Value of property immediately after casualty	-0-
Value of property actually destroyed	$2,000,000
Loss to be taken into account for purposes of section 165(a): Lesser amount of property actually destroyed ($2,000,000) or adjusted basis of property ($100,000)	$100,000
Less: Insurance received	-0-
Deduction allowable	$100,000

Land:

Value of property immediately before casualty	$1,000,000
Less: Value of property immediately after casualty	800,000
Value of property actually destroyed	$200,000
Loss to be taken into account for purposes of section 165(a): Lesser amount of property actually destroyed ($200,000) or adjusted basis of property ($500,000)	$200,000
Less: Insurance received	-0-
Deduction allowable	$200,000

Total:

Deduction allowable for building	$100,000
Deduction allowable for land	$200,000
Total deduction allowable under section 165	$300,000

See §§1.165-7(b)(2)(i) and 1.165-7(b)(3), *Example (2)*, of the regulations. *See generally* Rev. Rul. 71-161, 1971-1 C.B. 76, which explains how to calculate the allowable deduction for a casualty loss caused by a natural disaster.

Because the building was used in a rental activity for the year of the casualty, the $300.000 casualty loss allowed by section 165 of the Code arose in connection with the conduct of a passive activity. Losses similar in cause and severity do not recur regularly in A's rental activity. A sustained the loss during a taxable year beginning before January 1, 1990, and treated the deduction as a deduction that was not from a passive activity on A's return for the taxable year. Under new §1.469-2T(d)(2)(xi) of the temporary regulations (see section III of this notice), the casualty loss is not a passive activity deduction. Therefore, section 469 does not limit the deductibility of A's $300,000 casualty loss allowable under section 165. If the requirements of section 165(i) are met, A may deduct the $300,000 loss in 1988 rather than 1989.

Because A retains the land after the casualty, A has not disposed of all the assets used in the activity. Therefore, A has not disposed of A's entire interest in the activity for purposes of section 469(g) of the Code. A may not deduct under section 469(g) the $100,000 of passive activity deductions from the activity that were disallowed as of the beginning of 1989 or any current-year deductions from the activity besides the casualty loss. However, A may take those deductions in 1989 to the extent of A's passive activity gross income for 1989, under the general rules of section 469. *See* §1.469-2T(b) of the temporary regulations. In addition, section 469(i) may allow a deduction for up to $25,000 of an individual's losses from rental real estate activities.

Example (2)

The facts are the same as in Example (1). In 1990, A pays a contractor $200,000 to demolish the building and remove the rubble. A may not deduct the $200,000 demolition expense. Under section 280B of the Code, A must charge that expense to capital account with respect to the land. A's basis in the land after the demolition is $500,000, calculated as follows:

Basis before casualty	$500,000
Less: Deduction allowed in 1989 for casualty loss to land	200,000
Basis before demolition	$300,000
Plus: Demolition expense	200,000
Basis after demolition	$500,000

Example (3)

The facts are the same as in Example (2), except that before the earthquake, the building was burdened by legal restrictions that limited A's use of the land. Those restrictions lapsed when the building was destroyed. The earthquake did not reduce the land's fair market value, and may have increased it. Therefore, A does not have a casualty loss with respect to the land. A's basis in the land after the demolition is $700,000, calculated as follows:

Basis before casualty	$500,000
Less: Deduction allowed in 1989 for casualty loss to land	-0-
Basis before demolition	$500,000
Plus: Demolition expense	200,000
Basis after demolition	$700,000

VI. EFFECTIVE DATE

The amendments of §§1.469-2T(c)(7) and 1.469-2T(d)(2) of the temporary regulations described in this notice apply as if they had been included in those provisions as originally promulgated (T.D. 8175, 1988-1 C.B. 191, February 25, 1988). In general, §§1.469-2T(c)(7) and 1.469-2T(d)(2) apply for taxable years beginning after December 31, 1986. *See* §1.469-11T(a).

If a taxpayer sustained a casualty or theft loss for any taxable year for which a Federal income tax return has been filed, the taxpayer may want to take advantage of new §1.469-2T(d)(2)(xi) and amend the return for such year. This will affect the amount and allocation of the taxpayer's disallowed passive activity loss and credit that is carried over to subsequent taxable years. It will also affect the character of any reimbursement of the loss that is included in gross income under §1.165-1(d)(2)(iii) of the regulations. Therefore, taxpayers who amend their returns to take advantage of §1.469-2T(d)(2)(xi) of the temporary regulations must also recompute and reallocate their disallowed passive activity loss and credit on amended returns for all other affected years for which returns have been filed. In addition, the amount and allocation of the disallowed passive activity loss and credit for 1989 and future taxable years must reflect any change in the taxpayer's carryovers. For more information on allocating the passive activity loss and credit among activities, see §1.469-1T(f).

VII. ADMINISTRATIVE PRONOUNCEMENT

This notice serves as an "administrative pronouncement" as that term is described in §1.6661-3(b)(2) of the regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Weighted Average Interest Rate Update

Notice 90-22

Notice 88-73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of section 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 (OBRA 1987).

The notice also provides that an announcement will be published monthly to provide the weighted average and the permissible range for the

plan years beginning each month. The following rates were determined for the plan years beginning each month.

Month	Year	Weighted Average	Permissible Range
February	1990	8.55	7.70 to 9.41

Administrative Pronouncement

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Arbitrage Restrictions on Qualified Student Loan Bonds (Corrections)

Notice 90-23

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to final regulations relating to arbitrage restrictions on qualified student loan bonds (T.D. 8284) which was published in the Federal Register on Thursday, January 25, 1990 (55 FR 2511) [page 24, this Bulletin].

SUPPLEMENTARY INFORMATION:

Background

On January 25, 1990, Treasury decision (8284) relating to arbitrage restrictions on qualified student loan bonds was published in the Federal Register (55 FR 2511). The amendments provided rules under section 148 of the Internal Revenue Code changed by the Tax Reform Act of 1984 and the Tax Reform Act of 1986.

Need for Correction

As published, the Treasury decision contains errors which may prove to be misleading and are in need of correction.

The following rates were determined for the plan years beginning in the months shown below.

Correction of Publication

Paragraph 1. On page 2512, in the preamble, under the caption "Public Comments", in column 1, lines 12 through 15, the language "include (as under §1.103-13(c)(5)(iv)) the underwriter's spread and the cost of purchasing, carrying, and selling or redeeming student loans." is removed and the language "include (as under §1.103-13(c)(5)(iv)(A) and (B)) the underwriter's spread," is added in its place.

Par. 2. On page 2512, column 2, line 5 of §1.148(b)(ii), the language "meaning of §1.103-13(c)(5)(iv)) that are" is removed and the language "meaning of §1.103-13(c)(5)-(iv)(A) and (B)) that are" is added in its place.

Dale D. Goode,
Federal Register Liaison Officer, Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on February 12, 1990, 8:45 a.m., and published in the issue of the Federal Register for February 13, 1990, 55 F.R. 4998)

Section 6039D Reporting Requirements

Notice 90-24

PURPOSE

This notice provides guidance on the reporting requirements imposed on specified fringe benefit plans under section 6039D of the Internal Revenue Code.

BACKGROUND

Prior to amendment by the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 1, (TRA '86), section 6039D of the Code required employers maintaining group legal services plans described in section 120, cafeteria plans described in section 125, and educational assistance programs described in section 127 to file an annual return with the Internal Revenue Service. Announcement 86-20, 1986-7 I.R.B. 34, requires the return for these plans to be filed on either Form 5500, Annual Return/Report of Employee Benefit Plan (with 100 or more participants); Form 5500-C, Return/Report of Employee Benefit Plan (with fewer than 100 participants); or Form 5500-R, Registration Statement of Employee Benefit Plan (with fewer than 100 participants).

Section 1151(h) of TRA '86 amended section 6039D and expanded the reporting obligation requirement to group-term life insurance plans described in section 79, accident and health plans described in sections 105 and 106, and dependent care assistance programs described in section 129. TRA '86 also modified the section 6039D reporting requirements by requiring that employers report the number of highly compensated employees (1) of the employer, (2) eligible to participate in the plan, and (3) participating in the plan for all plans subject to section 6039D reporting. The expanded reporting requirements became effective for plan years beginning after December 31, 1988.

Pub. L. No. 101-140, §202, 103 Stat. 830 (1989), enacted on November 8, 1989, repealed section 89 of the Code and certain provisions of section 1151 of TRA '86 that were made irrelevant by the repeal of section 89. Pub. L. No. 101-140, did not, however, affect the amendments made by section 1151 of TRA '86 to section 6039D.

REPORTING REQUIREMENTS

The Service will be developing the necessary forms and instructions to assist taxpayers in complying with the expanded reporting requirements of section 6039D of the Code.

Section 79, Section 105, Section 106 and Section 129 Plans

Until the Service provides further guidance, employers maintaining plans under sections 79, 105 and 106, or 129, are not required to file information returns with respect to section 6039D. The section 6039D reporting obligations for these plans will be prospective from the date of publication of further guidance and will apply only to plan years beginning on or after that date.

Section 120, Section 125 and Section 127 Plans

Employers maintaining plans under sections 120, 125, or 127 that prior to the TRA '86 amendments were required by section 6039D of the Code to file an annual return, must continue to file Form 5500, Form 5500-C, or Form 5500-R, whichever is applicable, by the filing date of that return (generally, the last day of the 7th month after the plan year ends). However, these employers are not required to supply the additional information regarding highly compensated employees required by the section 1151 of TRA '86 amendments to section 6039D, for any plan year beginning before the Service issues further guidance on these expanded section 6039D reporting requirements. The expanded section 6039D reporting obligations for these plans will apply only to plan years beginning on or after the date of publication of further guidance.

III. REQUEST FOR COMMENTS

Employers and their representatives are invited to comment on possible approaches to section 6039D reporting. Comments should be mailed by June 25, 1990, to: Commissioner of Internal Revenue, Attention CC:EE:6 (EE: 45-1474-89), Room 5241, 1111 Constitution Ave., N.W., Washington, D.C. 20224.

IV. PROCEDURAL INFORMATION

This notice constitutes authority within the meaning of section 6662(d)(2)(B)(i) of the Code and may be relied upon by taxpayers to the same extent as a revenue ruling or revenue procedure.

Earnings and Profits of Controlled Foreign Corporations

Notice 90-25

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to temporary regulations (T.D. 8283).

SUMMARY: This document contains corrections to Treasury Decision 8283, which was published in the FEDERAL REGISTER for Thursday, January 25, 1990, (55 FR 2515) [page 148, this Bulletin]. The temporary regulations relate to the earnings and profits of controlled foreign corporations.

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations that are the subject of these corrections relate to the election or adoption of tax accounting methods affecting the computation of earnings and profits of a controlled foreign corporation in post-1986 taxable years. Changes to the applicable law were made by the Tax Reform Act of 1986.

Need for Correction

As published, T.D. 8283 contains typographical and other errors which may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the temporary regulations (T.D. 8283) which was the subject of FR Doc. 90-1633, is corrected as follows:

1. On page 2517, column 1, fourth line of §1.964-1T(g)(6) Example (1)(iii), the language "Commissioner to be due to inadvertance or" should read "Commissioner to be due to".

2. On page 2517, column 2, fourth line of §1.964-1T(g)(6) Example (2)(iii), the language "Commissioner to be due to inadvertance or" should read "Commissioner to be due to".

3. On page 2517, column 2, fourth line of §1.964-1T(g)(6) Example (3)(iii), the language "Commissioner to be due to inadvertance or" should read "Commissioner to be due to".

(Filed by the Office of the Federal Register on March 2, 1990, 8:45 a.m., and published in the issue of the Federal Register for March 5, 1990, 55 F.R. 7711)

Rules Relating to the Adjustment to the Pools of Foreign Taxes and Earnings and Profits When the Allowable Foreign Tax Credit Changes

Notice 90-26

The Internal Revenue Service announces the suspension of section 1.905-3T(d)(2)(ii)(A) of the Temporary Income Tax Regulations and that part of section 1.905-3T(d)(2)(ii)(C) which refers to that regulations. Section 1.905-3T(d)(2)(ii)(A) requires taxpayers to recompute the foreign tax credit claimed on their current year income tax return to account for foreign tax redeterminations that (1) affect the amount of foreign tax deemed paid under section 902 or 960 of the Internal Revenue Code and (2) occur more than 90 days before the due date (with extensions) of the tax return for that taxable year and before the actual filing date. Section 1.905-3T(d)(2)(ii)(C) permits taxpayers to elect to apply section 1.905-3T(d)(2)(ii)(A) to a foreign tax redetermination occurring within 90 days of the due date (with extensions) and before the actual filing date. Pending the issuance of final regulations under section 905(c), redeterminations otherwise subject to section 1.905-3T(d)-(2)(ii)(A) or (C) must be accounted for through adjustment to the appropriate pools of earnings and profits and foreign taxes in the manner described in section 1.905-3T(d)(3) and subject to the exceptions set forth in section 1.905-3T(d)(4). The suspension announced herein is effective for taxes deemed paid or accrued with respect to earnings and profits of a foreign corporation accumulated in taxable years of the foreign corporation beginning after December 31, 1986.

Application of the Built-in Gain Rules of Sections 382, 384, and 1374 of the Code to Installment Sales

Notice 90-27

1. *Installment Sales and Section 384*

The purpose underlying section 384 of the Internal Revenue Code is to prevent trafficking in tax benefits in connection with certain acquisitive reorganizations or stock acquisitions, by preventing a party to a business combination from using its losses to offset the unrealized gain inherent in the assets of another party to the transaction. H.R. Rep. No. 391, 100th Cong., 1st Sess. 1093 (1987). Section 384(a) provides that, if a corporation acquires directly (or through one or more other corporations) control of another corporation, or if the assets of a corporation are acquired by another corporation in a reorganization under sections 368(a)(1)(A), (C), or (D), and either of such corporations is a "gain corporation," income for any recognition period taxable year, to the extent attributable to recognized built-in gains, shall not be offset by any preacquisition loss (other than a preacquisition loss of the gain corporation). Section 384(f)(1) provides that the Secretary shall issue such regulations as may be necessary to ensure that the purposes of section 384 may not be circumvented through the use of any provision of law or regulations.

Under section 384(c)(3) of the Code, a "preacquisition loss" includes any net operating loss carryforward to the taxable year in which the acquisition date occurs, any net operating loss for that year to the extent such loss is allocable to the period in that year on or before the acquisition date, and any recognized built-in loss. Under section 384(c)(4), a "gain corporation" is any corporation with a net unrealized built-in gain. In general, a corporation has a net unrealized built-in gain if the fair market value of its assets, immediately before the acquisition date, exceeds their aggregate adjusted bases. If, however, the amount of the net unrealized built-in gain of any corporation is not greater than the lesser of (i) 15 percent of the fair market value of its assets immediately before the acquisition date, or (ii) $10,000,000, the net unrealized built-in gain shall be zero. Sections 384(c)(8) and 382(h)(3)(B)(i).

Under section 384(c)(1)(A) of the Code, a "recognized built-in gain" is any gain recognized during the recognition period on the disposition of any asset, except to the extent the gain corporation (or, in a case described in section 384(a)(1)(B), the acquiring corporation) establishes that (i) such asset was not held by the gain corporation on the acquisition date, or (ii) the gain exceeds the excess, if any, of the fair market value of the asset on the acquisition date over its adjusted basis on that date. Section 384(c)(1)(C) limits the amount of the recognized built-in gain for any recognition period taxable year to the net unrealized built-in gain, reduced by the amount of any recognized built-in gain for prior years ending in the recognition period which (but for the application of section 384) would have been offset by preacquisition losses. The term "recognition period" means the five-year period beginning on the acquisition date, and the term "recognition period taxable year" means any taxable year any portion of which is in the recognition period.

The purpose underlying the installment method of reporting income under section 453 of the Code is to alleviate the potential liquidity problems that might arise for taxpayers if they were required to recognize all of the income realized from the disposition of an asset when all or a portion of the sale price remains to be paid after the taxable year of the disposition. S. Rep. No. 1000, 96th Cong., 2d Sess. 7 (1980), 1980-2 C.B. 494, 497. Under section 453, an allocable share of the gross profit on an "installment sale," as defined in section 453(b), is recognized and taken into income in any year in which an installment payment is received by the seller. Under section 453(d), a taxpayer may elect out of reporting a sale on the installment method. An installment sale of an asset by a gain corporation that defers any portion of the payments with respect to the sale beyond the recognition period, would (but for the application of this Notice) result in avoiding the characterization of such gain as recognized built-in gain.

The Service has determined that the purposes underlying section 384 of the Code would not be carried out if a gain corporation could dispose of its assets either prior to or during the recognition period in a transaction in which installments are payable after expiration of the period, and thereby avoid the characterization of gain from the sale as recognized built-in gain by reporting the sale under the section 453 installment method. In order to carry out the purposes of section 384, the Service will issue regulations under section 384(f)(1) to provide that, if a taxpayer sells a built-in gain asset either prior to or during the recognition period in an installment sale and recognizes the income from the sale pursuant to the installment method, the provisions of section 384 will continue to apply to gain recognized from the installment sale after the recognition period (including any gain recognized from the disposition of the installment obligation). In such a situation, the regulations will treat the recognition period as if, solely with respect to such recognized gain, the recognition period were extended through the date of the last installment payment (or the date of the disposition of the installment obligation). All of the requirements for the application of the section 384 limitation on the use of preacquisition losses will be taken into account during the extended recognition period.

The regulations to be issued pursuant to this section 1 of this Notice will also apply if a corporation transfers a built-in gain asset to an affiliated corporation, the gain is deferred under the consolidated return regulations (see sections 1.1502-13 and 1.1502-14 of the Income Tax Regulations), and before the close of the recognition period the affiliated corporation sells the built-in gain asset in a sale reportable under the installment method. In general, any such deferred recognized gain will constitute "recognized built-in gain" when such gain is taken into account by the selling or distributing member and will be subject to section 384, whether or not the installment payment is made after the recognition period. See section 1.1502-13T(m)(1).

2. *Installment Sales and Section 382*

The amount of taxable income of a loss corporation for any taxable year following an ownership change that can be offset by pre-change losses (*e.g.*, net operating loss carryforwards, certain net operating losses for the taxable year including the change date, and certain built-in losses) may not exceed the section 382 limitation

for that year. Under section 382(b) of the Code, the section 382 limitation generally is an amount equal to the value of the old loss corporation multiplied by the long-term tax-exempt rate. Section 382(h)(1)(A) provides that, if a loss corporation has a net unrealized built-in gain, the section 382 limitation for any recognition period taxable year is increased by the recognized built-in gain for that year. Section 382(m) provides that regulations shall be issued as may be necessary or appropriate to carry out the purposes of section 382.

The increase in the section 382 limitation for any recognized built-in gain in a recognition period taxable year is limited to the amount of the net unrealized built-in gain, reduced by the amount of any recognized built-in gain for prior years ending in the recognition period. The net unrealized built-in gain of a loss corporation for purposes of section 382 of the Code is determined in the same manner as net unrealized built-in gain is determined with respect to a gain corporation for purposes of section 384 (as described in section 1 of this Notice). In contrast to the statutory presumptions in favor of finding that built-in gain results from any disposition of appreciated property by the gain corporation under section 384, section 382(h)(2)(A) provides that a "recognized built-in gain" is any gain recognized during the recognition period on the disposition of an asset only to the extent it is established that (i) the asset was held by the loss corporation immediately before the change date, and (ii) the gain so recognized does not exceed the excess of the fair market value of the asset on the change date over its adjusted basis on such date. The term "recognition period" means the five-year period beginning on the change date, and the term "recognition period taxable year" means any taxable year any portion of which is in the recognition period.

The Service has determined that regulations similar to those to be issued with respect to installment sales under section 384 of the Code (as described in section 1 of this Notice) also will be issued under section 382(m). The regulations will provide that, if a taxpayer sells a built-in gain asset either prior to or during the recognition period in an installment sale and gain is reported under the section 453 installment method, the provisions of section 382(h) will continue to apply to gain recognized from the installment sale after the recognition period (including any gain recognized from the disposition of the installment obligation). As a result, the recognized gain will cause an increase in the section 382 limitation for the taxable year of payment, provided that such an increase otherwise would be permitted under section 382(h) if, solely with respect to such recognized gain, the recognition period were extended through the date of the last installment payment (or the date of the disposition of the installment obligation).

The regulations to be issued pursuant to section 2 of this Notice will also apply if a corporation transfers a built-in gain asset to an affiliated corporation, the gain is deferred under the consolidated return regulations (see sections 1.1502-13 and 1.1502-14 of the regulations), and before the close of the recognition period the affiliated corporation sells the built-in gain asset in a sale reportable under the installment method. In general, any such deferred recognized gain will constitute "recognized built-in gain" when such gain is taken into account by the selling or distributing member and will cause an increase in the section 382 limitation for the taxable year of payment, provided that such an increase otherwise would be permitted under section 382(h) if the recognition period were extended through the date of the last installment payment (or the date of the disposition of the installment obligation). See section 1.1502-13T(m)(1).

3. *Installment Sales and Section 1374*

Section 1374 of the Code, as amended by subtitle D of title VI of the Tax Reform Act of 1986 (the "Act"), imposes a corporate-level tax with respect to certain gain recognized by an S corporation. Generally, the tax is imposed for any taxable year beginning in the recognition period of an S corporation in which the corporation has a net recognized built-in gain. Under section 1374(d)(2)(A), the term "net recognized built-in gain" means the lesser of (i) the amount that would be the taxable income of the corporation if only recognized built-in gains and recognized built-in losses were taken into account, or (ii) the corporation's taxable income (determined as provided in section 1375(b)(1)(B)). If, for any taxable year, the lesser amount is the corporation's taxable income determined under section 1375(b)(1)(B), the amount by which the excess of recognized built-in gain over recognized built-in loss exceeds taxable income is treated as recognized built-in gain in the succeeding taxable year. Section 1374(d)(2)(B). The amount of the net recognized built-in gain taken into account under section 1374 for any taxable year is limited to the excess, if any, of the net unrealized built-in gain over the net recognized built-in gain for prior taxable years beginning in the recognition period.

Generally, net unrealized built-in gain for purposes of section 1374 of the Code is determined in the same manner as that in which built-in gain is determined with respect to a gain corporation under section 384 (as described in section 1 of this Notice). See section 1374(d)(1). However, there is no rule in section 1374 providing that the net unrealized built-in gain is zero if the net unrealized built-in gain of the corporation does not exceed the lesser of 15 percent of the fair market value of its assets or $10,000,000. The term "recognition period" means the ten-year period beginning on the first day of the first taxable year for which the corporation was an S corporation.

Section 1374(e) of the Code provides that regulations shall be issued as may be necessary to carry out the purposes of section 1374. In addition, section 337(d), in part, provides that regulations shall be issued as may be necessary or appropriate to carry out the purposes of the amendments under the Act made to section 1374, including regulations to ensure that such purposes not be circumvented through the use of any provision of law or regulation. The Service has determined that the purposes underlying the repeal of the General Utilities doctrine and the related amendments to section 1374 would fail to be carried out in certain cases if an S

corporation disposes of an asset either prior to or during the recognition period in an installment sale reported under the installment method.

Accordingly, the Service will issue regulations governing the treatment of installment sales under section 1374 of the Code, including regulations providing that, in certain cases, section 1374 will continue to apply to income recognized under the installment method during a taxable year ending after the expiration of the recognition period. Under the regulations, if a taxpayer sells an asset either prior to or during the recognition period and recognizes income (either during or after the recognition period) from the sale under the installment method, the income will, when recognized, be taxed under section 1374 to the extent it would have been so taxed in prior taxable years if the selling corporation had made the election under 11 section 453(d) not to report the income under the installment method. For purposes of determining the extent to which the income would have been subject to tax if the section 453(d) election had not been made, the taxable income limitation of section 1374(d)(2)(A)(ii) and the built-in gain carryover rule of section 1374(d)(2)(B) will be taken into account.

Example 1. In year 1 of the recognition period under section 1374, a corporation realizes a gain of $100,000 on the sale of an asset with built-in gain. The corporation is to receive full payment for the asset in year 11. Because the corporation does not make an election under section 453(d), all $100,000 of the gain from the sale is reported under the installment method in year 11. If the corporation had made an election under section 453(d) with respect to the sale, the gain would have been recognized in year 1 and, taking into account the corporation's income and gains from other sources, application of the taxable income limitation of section 1374(d)(2)(A)(ii) and the built-in gain carryover rule of section 1374(d)(2)(B) would have resulted in $40,000 of the gain being subject to tax during the recognition period under section 1374. Therefore, the regulations will subject $40,000 of the gain recognized in year 11 to tax under section 1374.

Example 2. In year 1 of the recognition period under section 1374, a corporation realizes a gain of $100,000 on the sale of an asset with built-in gain. The corporation is to receive full payment for the asset in year 6. Because the corporation does not make an election under section 453(d), all $100,000 of the gain from the sale is reported under the installment method in year 6. If the corporation had made an election under section 453(d) with respect to the sale, the gain would have been recognized in year 1 and, taking into account the corporation's income and gains from other sources, application of the taxable income limitation of section 1374(d)(2)(A)(ii) and the built-in gain carryover rule of section 1374(d)(2)(B) would have resulted in all of the gain being subjected to tax under section 1374 in years 1 through 5. Therefore, notwithstanding that the taxable income limitation of section 1374(d)(2)(A)(ii) might otherwise limit the taxation of the gain recognized in year 6, the regulations will provide that the entire $100,000 of gain will be subject to tax under section 1374 when it is recognized in year 6.

These regulations shall not apply for purposes of the application of section 1374 of the Code as in effect prior to amendment by the Act.

The Service will also issue regulations to provide rules similar to those described in this Notice for regulated investment companies and real estate investment trusts that elect to be subject to rules similar to the rules of section 1374 of the Code. See Notice 88-19, 1988-1 C.B. 486.

4. *Effective Date*

The regulations to be issued pursuant to this Notice under the authority of sections 384(f)(1), 382(m), 1374(e), and 337(d) of the Code will be effective for installment sales occurring on or after March 26, 1990. For purposes of these effective dates, if the installment sale was pursuant to a binding written contract entered into and in continuous effect until the sale, the date the contract became binding is treated as the date of the sale.

Taxable Year of Inclusion of Payments Under Title I of the Disaster Assistance Act of 1989

Notice 90-28

In the circumstances described in this notice, the Internal Revenue Service will permit a taxpayer to elect to defer crop insurance proceeds under section 451(d) of the Internal Revenue Code without requiring the taxpayer to also defer federal disaster payments.

Section 451(d) of the Code allows a taxpayer reporting on the cash receipts and disbursements method of accounting who receives insurance proceeds as a result of destruction or damage to crops to elect to include the proceeds in income for the taxable year following the taxable year of destruction or damage, if the taxpayer establishes that under normal business practices income from the crops would have been reported in any taxable year following the year of destruction or damage. Section 1.451-6(a)(2) of the Income Tax Regulations provides that any such election will be deemed to cover all insurance proceeds that are attributable to crops representing a single trade or business under section 446(d). Section 1.451-6(b)(2) of the regulations provides further that an election under section 451(d) is binding for the taxable year for which the election was made unless the district director consents to a revocation of such election.

On March 1, 1990, section 1.451-6T of the temporary Income Tax Regulations was published in the Federal Register. Section 1.451-6T provides that, solely for purposes of section 451(d) of the Code, federal payments received as a result of (1) destruction or damage to crops caused by drought, flood, or any other natural disaster, or (2) the inability to plant crops because of such a natural disaster, shall be treated as insurance proceeds received as a result of destruction or damage to crops. Under this regulation a farmer who receives payments in 1989 under title I of the Disaster Assistance Act of 1989 (Pub. L. No. 101-82, 103 Stat. 564) may elect to include the payments in income in 1990 if the

other requirements of section 451(d) are satisfied.

Section 6654(i) of the Code provides that a farmer who files a return for a taxable year on or before March 1 of the following year and pays in full the amount computed on the return as payable shall not be subject to the addition to tax imposed by section 6654(a) for the failure to pay estimated tax. As a result, the 1989 federal income tax returns of many farmers were filed without the guidance provided by section 1.451-6T of the temporary regulations. Accordingly, these returns may reflect elections under section 451(d) for eligible crop insurance proceeds but not federal disaster payments.

On a federal income tax return for a taxable year ending before April 1, 1990, in which payments were received under the Disaster Assistance Act of 1989 that are eligible for deferral under section 1.451-6T of the temporary regulations, the Service will permit the taxpayer to elect deferral for insurance proceeds without requiring the taxpayer to also defer the federal disaster payments. Accordingly, a taxpayer who makes an election under section 451(d) on such a return with respect to insurance proceeds but not with respect to federal disaster payments does not have to file an amended return, or take any other action, with respect to the treatment of such federal disaster payments. Alternatively, such a taxpayer may file an amended return to extend the election to the taxpayer's federal disaster payments eligible for deferral under section 1.451-6T of the temporary regulations. However, if such a taxpayer does not file an amended return the Service will not deem an election made under section 451(d) with respect to insurance proceeds to cover federal disaster payments.

Taxpayers should note that while these rules effectively permit an election to defer insurance proceeds but not federal disaster payments, these rules do not permit an election to defer federal disaster payments but not insurance proceeds.

Nonconventional Source Fuel Credit; Publication of Inflation Adjustment Factor and Reference Price for Calendar Year 1989

Notice 90-29

AGENCY: Internal Revenue Service, Treasury.

ACTION: Publication of inflation adjustment factor and reference price for calendar year 1989 as required by section 29(d)(2)(A) of the Internal Revenue Code (26 U.S.C. section 29(d)(2)(A)) (formerly section 44D, renumbered by the Deficit Reduction Act of 1984).

SUMMARY: The inflation adjustment factor and reference price are used in determining the availability of the tax credit for production of fuel from nonconventional sources under section 29 of the Internal Revenue Code.

DATES: The 1989 inflation adjustment factor and reference price apply to qualified fuels sold during calendar year 1989.

INFLATION FACTOR: The inflation adjustment factor for calendar year 1989 is 1.6069.

PRICE: The reference price for all qualified fuels is $15.85 per equivalent barrel for the 1989 calendar year.

Because the above reference price does not exceed $23.50 multiplied by the inflation adjustment factor, the phaseout of credit provided for in section 29(b)(1) of the Internal Revenue Code does not occur for any qualified fuel based on the above reference price.

Kenneth Klein,
Technical Associate
Chief Counsel.

(Filed by the Office of the Federal Register on March 23, 1990, 8:45 a.m., and published in the issue of the Federal Register for March 26, 1990, 55 F.R. 11104)

Real Estate Mortgage Investment Conduits; Reporting Requirements and Other Administrative Matters (T.D. 8259 Correction)

Notice 90-30

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to temporary regulations.

SUMMARY: This document contains a correction to Treasury Decision 8259, which was published in the Federal Register for Thursday, September 7, 1989, at 54 FR 37098 [1989-2 C.B. 234]. The temporary regulations relate to real estate mortgage investment conduits.

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations that are the subject of these corrections prescribe the manner in which an entity elects status as a real estate mortgage investment conduit (REMIC) for Federal income tax purposes and procedures to be followed when filing a Federal income tax return as a REMIC. The regulations also require REMICs and certain other issuers to file information returns with the Internal Revenue Service and to provide notice to holders of REMIC interests or other debt instruments to which section 1272(a)(6) applies of income and certain allocable expenses attributable to their interests. These provisions were added or amended by the Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988.

Need for Correction

As published, T.D. 8259 contains an error which may be misleading and is in need of clarification.

Correction of Publication

Accordingly, the publication of the temporary regulations (T.D. 8259) which was the subject of FR Doc. 89-20916, is corrected as follows: §602.101 [Corrected]

On page 37107, third column, instructional Par. 7. which reads "Section 602.101(c) is amended by adding to the table in the appropriate place—" should be changed to read "Section 602.101(c) is amended by revising the following entries in the table to read as follows:"

Dale D. Goode,
Federal Register Liaison Officer,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on March 29, 1990, 8:45 a.m., and published in the issue of the Federal Register for March 30, 1990, 55 F.R. 11906)

Treatment of Dual Consolidated Losses (T.D. 8261 Correction)

Notice 90-31

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to temporary regulations.

SUMMARY: This document contains a correction to the Federal Register publication for Friday, September 8, 1989, at 54 FR 37314 [1989-2 C.B. 220]. The temporary regulations related to the definition of "dual consolidated losses" for purposes of determining whether the net operating loss of a domestic corporation is available to reduce the taxable income of any other member of its affiliated group.

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations (T.D. 8261) that are the subject of this correction were added to the Internal Revenue Code of 1986 by section 1249 of the Tax Reform Act of 1986 (Pub. L. 99-514).

Need for Correction

As published, the temporary regulations contain an error which may prove to be misleading and is in need of clarification.

Correction of Publication

Accordingly, the publication of the temporary regulations which were the subject of FR Doc. 89-21072, is corrected as follows:

§602.101 [Corrected]

Paragraph 1. On page 37324, first column, in §602.101, line 3 of instructional paragraph 4., the language "the table §1503-2T *** 1545-1083." should be removed and the language "the table §1.1503-2T *** 1545-1083" added in its place.

Dale D. Goode,
Federal Register Liaison Officer,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on March 29, 1990, 8:45 a.m., and published in the issue of the Federal Register for March 30, 1990, 55 F.R. 11906)

Weighted Average Interest Rate Update

Notice 90-32

Notice 88-73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of section 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 (OBRA 1987).

The notice also provides that an announcement will be published monthly to provide the weighted average and the permissible range for the plan years beginning each month. The following rates were determined for the plan years beginning each month. The following rates were determined for the plan years beginning in the months shown below.

Month	Year	Weighted Average	Permissible Range
March	1990	8.55	7.70 to 9.41

Administrative Pronouncement

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

List of Countries Requiring Cooperation With an International Boycott

Notice 90-33

In order to comply with the mandate of section 999(a)(3) of the Internal Revenue Code of 1954, the Department of the Treasury is publishing a current list of countries which may require participation in, or cooperation with, an international boycott (within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954). The list is the same as the prior quarterly list published in the Federal Register.

On the basis of the best information currently available to the Department of the Treasury, the following countries may require participation in, or cooperation with, an international boycott (within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954).

Bahrain
Iraq
Jordan
Kuwait
Lebanon
Libya
Oman
Qatar
Saudi Arabia
Syria
United Arab Emirates
Yemen, Arab Republic
Yemen, Peoples Democratic Republic of

Dated: March 29, 1990.

Kenneth W. Gideon,
Assistant Secretary for Tax Policy.

(Filed by the Office of the Federal Register on April 6, 1990, 8:45 a.m., and published in the issue of the Federal Register for April 9, 1990, 55 F.R. 13212)

Returns Relating to Persons Receiving Contracts From Federal Executive Agencies (Corrections to T.D. 8275)

Notice 90-34

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to final regulations that were published in the Federal Register on Wednesday, December 6, 1989 (54 FR 50307 [1989-2 C.B. 245]) as Treasury Decision 8275. The rules related to compliance with the new reporting requirements imposed by section 6050M for returns relating to persons receiving contracts from Federal executive agencies.

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of these corrections relate to section 6050M, which was added to the Internal Revenue Code by the Tax Reform Act of 1986.

Need for Correction

As published, the final regulations contain errors which may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations which were the subject of FR Doc. 89-28396, is corrected as follows:

Para. 1. On page 50369, in the preamble, first column, line 10, the language "(including into (or treated as entered" is corrected to read "(including their contract actions treated as new contracts entered into (or treated as entered".

§1.6050M [Amended]

Par. 2. On page 50370, second column, §1.6050M-1(b)(2)(iv) should read:

* * * * *

(iv) Certain schedule contracts. For purposes of this section, any of the following contracts entered into on behalf of one or more Federal executive agencies is not a "contract" to be reported by the General Services Administration or the Department of Veterans Affairs at the time of execution:

(A) A Federal Supply Schedule Contract entered into by the General Services Administration.

(B) An Automated Data Processing Schedule Contract entered into by the General Services Administration, or

(C) A schedule contract entered into by the Department of Veterans Affairs. Instead, an order placed by a Federal executive agency, including the General Services Administration or the Department of Veterans Affairs, under such a schedule contract is a "contract" for purposes of this section.

§1.6050M [Amended]

Par. 3. On page 50371, second column, line 4 of §1.6050M-1(d)(5)(i)(A) which reads "26 CFR 1.6050M-1(d)(5), to make, on the" should read "26 CFR 1.6050M-1(d)(5) to make, on the".

Par. 4. On page 50372, second column, immediately following the text of §301.6050M-1, the language "Approved: November 6, 1989. Lawrence B. Gibbs, Commissioner of Internal Revenue." should read as follows:

Lawrence B. Gibbs,
Commissioner of Internal Revenue.

Approved: November 6, 1989.

Kenneth W. Gideon.
Assistant Secretary of the Treasury.

Dale D. Goode,
Chief, Regulations Unit, Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on April 10, 1990, 8:45 a.m., and published in the issue of the Federal Register for April 11, 1990, 55 F.R. 13521)

Ozone-Depleting Chemicals Tax; Filing Return and Paying Tax

Notice 90-35

This Notice informs taxpayers that the Internal Revenue Service will issue temporary regulations setting forth procedures for filing returns under sections 4681 and 4682 of the Internal Revenue Code and paying the taxes imposed by section 4681. The temporary regulations will provide that the due date of a taxpayer's first return (Form 720, Quarterly Federal Excise Tax Return) under sections 4681 and 4682 will be April 30, 1990, but will grant an extension of time for filing the return until 30 days after the issuance of the temporary regulations (taxpayers do not need to apply for an extension). No penalty will be imposed on account of failure to file the return before the date for filing, as extended.

The due date of the first payment of tax imposed by section 4681 will be April 30, 1990. However, no penalty will be imposed on account of failure to deposit or pay the tax imposed by section 4681 prior to the due date for filing the return, as extended.

Interest on any amount of tax due for the quarter ended March 31, 1990, under section 4681 will be imposed from April 30, 1990. In order to avoid the interest charge, taxpayers may deposit the tax due under section 4681, on or before April 30, 1990, together with Form 8109, *Federal Tax Deposit Coupon,* at an authorized depository or the Federal Reserve Bank serving the taxpayer's area.

Taxpayers are reminded, however, that section 4682(h)(3) prescribes the date for the payment of the floor stocks tax on ozone-depleting chemicals and that payments of the floor stocks tax were due on April 1, 1990. Guidance relating to the floor stocks tax is provided in section V of Notice 90-8, page 305, this Bulletin.

Taxpayers who are liable for other excise taxes and must file Form 720 to report that liability may file the return relating to those other excise taxes without reporting any liability for the taxes imposed by sections 4681 and 4682. The temporary regulations will provide instructions for reporting the taxpayer's additional liability under sections 4681 and 4682.

Weighted Average Interest Rate Update

Notice 90-36

Notice 88-73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of section 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 (OBRA 1987).

The notice also provides that an announcement will be published monthly to provide the weighted average and the permissible range for the plan years beginning each month. The following rates were determined for the plan years beginning each month. The following rates were determined for the plan years beginning in the months shown below.

Month	Year	Weighted Average	Permissible Range
April	1990	8.56	7.70 to 9.42

Administrative Pronouncement

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Federal Tax Deposit Rules
Federal Tax Deposit Penalty

Notice 90-37

I. SCOPE

This notice provides guidance on changes made by Congress in the Revenue Reconciliation Act of 1989 (the "Act"), Pub. L. No. 101-239, 103 Stat. 2106 [page 210, this Bulletin], to the rules governing deposits of income tax withheld (including backup withholding) and taxes under the Federal Insurance Contributions Act (FICA) on an eighth-monthly basis.

II. BACKGROUND

A. CHANGE IN DEPOSIT RULES

In subtitle F (section 7632) of the Act, Congress revised the provisions under section 6302 of the Code for the deposit of withheld income taxes and FICA taxes, effective with respect to amounts required to be deposited after July 31, 1990.

New section 6302(g) of the Code, as added by the Act, provides as follows:

> (1) *In General.*—If, under regulations prescribed by the Secretary, a person is required to make deposits of taxes imposed by chapters 21 and 24 on the basis of eighth-month periods, such person shall, for the years specified in paragraph (2), make deposits of such taxes on the applicable banking day after any day on which such person has $100,000 or more of such taxes for deposit.
>
> (2) *Specified Years.*—For purposes of paragraph (1)—

In the case of:	The applicable banking day is:
1990.....	1st
1991.....	2nd
1992.....	3rd
1993.....	1st
1994.....	1st

(Pending legislative proposals could modify this schedule for years after 1990.)

The Act provides that for calendar year 1995 and thereafter, the Secretary shall prescribe regulations with respect to the date on which deposits of such taxes will be made in order to minimize the unevenness in the revenue effects of the new acceleration provision.

B. CHANGE IN DEPOSIT PENALTY

In subtitle G (section 7742) of the Act, Congress revised the penalty provisions under section 6656 of the Code for the failure to make deposits, effective with respect to failures made after December 31, 1989.

Under revised section 6656 of the Code, the penalty rate is 2 percent of the underdeposit if the failure is for not more than 5 days, 5 percent if the failure is for more than 5 days but not more than 15 days, and 10 percent if the failure is for more than 15 days. The penalty rate increases to 15 percent if the tax is not deposited on or before the earlier of (i) the day 10 days after the date of the first delinquency notice to the taxpayer under section 6303, or (ii) the day on which notice and demand for immediate payment is given under section 6861 or 6862 or the last sentence of section 6331(a).

III. PURPOSE

The Service will be developing regulations reflecting the changes made by Congress in the Act with respect to the federal tax deposit rules and failure-to-deposit penalty. Until further guidance is issued, this notice may be relied upon by those persons making deposits of withheld income tax (including backup withholding) and FICA taxes.

IV. APPLICATION OF DEPOSIT RULES

A. EFFECTIVE DATE — NEW SECTION 6302(g)

The Internal Revenue Service will apply the new provision to amounts required to be deposited *with respect to eighth-monthly deposit periods beginning after July 31, 1990.* Thus, the new provision will not apply to amounts due in August 1990 with respect to deposit periods ending before August 1, 1990.

B. APPLICATION OF SECTION 6302(g) "ACCELERATION" PROVISION

Under section 31.6302(c)-1(a)(1)(i) of the regulations, an employer who has undeposited taxes of $3,000 or more on hand at the close of an eighth-monthly period is required to deposit those taxes in a Federal Reserve Bank or authorized financial institution within 3 banking days after the close of such eighth-monthly period. "Eighth-monthly period" is defined as the first 3 days of a calendar month, days 4 through 7, 8 through 11, 12 through 15, 16 through 19, 20 through 22, 23 through 25, and the remainder of the calendar month following the 25th day.

The regulations under section 6302 of the Code provide that an employer depositing on an eighth-monthly basis generally is considered to be in compliance if a deposit for an eighth-monthly period is at least 95 percent of the amount required to be deposited and, if the eighth-monthly period is in the first or second month of the quarter, the underdeposit is remitted with the first deposit otherwise required after the 15th day of the next month. If the eighth-monthly period is in the last month of the quarter, the underdeposit must be remitted by the last day of the first month following the close of the quarter. This provision is the so-called "safe-haven" rule.

New section 6302(g) of the Code provides a special rule for persons depositing taxes on the basis of eighth-monthly periods. If, on any day, such a person has on hand, with respect to any eighth-monthly period, $100,000 or more of the taxes imposed by chapters 21 (FICA tax) and 24 (income tax withheld including backup withholding) for deposit, then that person must deposit those taxes by the close of the "applicable banking day" after such day, as provided by section 7632 of the Act. From August 1, 1990, through December 31, 1990, the applicable banking day is the first banking day.

Until further guidance is issued, the Service will apply new section 6302(g) of the Code as follows. If, during an eighth-monthly period, a person required to make deposits on an eighth-monthly basis has on hand for depos-

it at least $100,000 with respect to that eighth-monthly period, then that amount must be deposited by the close of the next banking day. If, by the end of the same eighth-monthly period, that same person has accumulated at least $3,000 but less than $100,000 in additional taxes for deposit with respect to that eighth-monthly period, then that amount must be deposited within three banking days after the end of the eighth-monthly period, under the general rule of section 31.6302(c)-1(a)(1)(i) of the regulations.

If, at the end of an eighth-monthly period, a depositor has on hand a sufficient undeposited amount to give rise to a deposit obligation with respect to that amount, then that deposit obligation is fixed, and that amount is not taken into account in determining whether on any succeeding day the $100,000 threshold amount in section 6302(g) of the Code has been reached. However, as in the past, if amounts on hand at the end of an eighth-monthly period are less than $3,000 and thus not subject to a deposit obligation, those amounts will be taken into account in determining amounts on hand in the succeeding eighth-monthly period. Finally, the 95 percent "safe-haven" rule will be applicable to deposits required to be made on an accelerated basis under section 6302(g).

The following examples illustrate how the new section 6302(g) "acceleration" provision applies:

Example 1: At the close of business on Thursday, August 2, 1990, Employer *A*'s payroll date, *A* has on hand $105,000 in FICA tax and income tax withheld. Notwithstanding section 31.6302(c)-1(a)(1)(i) of the regulations, *A*, pursuant to section 6302(g) of the Code, must deposit that amount by Friday, August 3, 1990, the next banking day after August 2, in order to prevent assertion of the failure-to-deposit penalty under section 6656.

Example 2: The facts are the same as in Example 1, except that on Friday, August 3, 1990, the close of an eighth-monthly period, *A* made a payroll payment that gave rise to an additional $10,000 in undeposited taxes. *A* must deposit the $10,000 by Wednesday, August 8, 1990, three banking days after the close of the eighth-monthly period, under the general rule of section 31.6302(c)-1(a)(1)(i) of the regulations. Because the $105,000 obligation described in Example 1 was fixed as of the close of business on Thursday, August 2, the $10,000 withheld on August 3 is the beginning of a separate and distinct deposit obligation.

Example 3: On Monday, August 13, 1990, Employer *B* accumulates $105,000 in income tax withheld and FICA taxes. Pursuant to section 6302(g) of the Code, *B* deposits that amount on Tuesday, August 14, 1990. At the close of business on Wednesday, August 15, 1990, the close of an eighth-monthly period, *B* has on hand an additional $2,500 in income tax withheld and FICA taxes. Under section 31.6302(c)-1(a)(1)(i) of the regulations, *B* is not required to make an additional deposit with respect to that eighth-monthly period since the amount on hand is less than $3,000. The undeposited $2,500 is carried forward to the next eighth-monthly period. On Thursday, August 16, 1990, *B* accumulates an additional $98,000 in withheld income tax and FICA taxes. Accordingly, on that date, *B* has on hand $100,500 in undeposited taxes. *B* is required to deposit that amount by the next banking day, Friday, August 17, 1990, under section 6302(g).

Example 4: At the close of business on Wednesday, August 15, 1990, the close of an eighth-monthly period, Employer *C* has on hand $50,000 of income tax withheld and FICA taxes. Pursuant to section 31.6302(c)-1(a)(1)(i) of the regulations, the $50,000 must be deposited within three banking days after August 15 in order to prevent assertion of the failure-to-deposit penalty. On Thursday, August 16, *C* has on hand an additional $60,000 of income tax withheld and FICA taxes. The acceleration provision of section 6302(g) does not require payment by the next banking day even though *C* has on hand $110,000 ($50,000 + $60,000) of FICA tax and income tax withheld, because the obligation to deposit the $50,000 was fixed as of the close of business on Wednesday, August 15, and that amount is not to be taken into account for purposes of the acceleration provisions of section 6302(g). The $50,000 must be deposited by Monday, August 20, 1990, three banking days after Wednesday, August 15th. The determination of the date by which the $60,000 must be deposited depends on what additional amounts, if any, are accumulated during the August 16-19 eighth-monthly period.

Example 5: The facts are the same as in Example 4 except the additional amount on hand on Thursday, August 16, is $105,000, not $60,000. The $105,000 must be deposited by Friday, August 17, 1990, pursuant to the provisions of section 6302(g) of the Code.

Example 6: On Thursday, August 23, 1990, Employer *D*'s payroll date, *D* estimated that it had on hand $2 million in FICA tax and income tax withheld. Pursuant to section 6302(g) of the Code, *D* deposited that amount by the close of the next banking day, Friday, August 24, 1990. On Monday, August 27, *D* determined that the actual FICA tax and income tax withheld for the August 23 payroll date was $2.1 million. Provided that the undeposited $100,000 is deposited with the first deposit otherwise required after September 15, 1990, *D* is deemed, under section 31.6302(c)-1(a)(1)(i) of the regulations, to be in compliance with section 6302 because at least 95% (95.24% in this case) was deposited. Under these circumstances, the $100,000 in undeposited taxes is not subject to the acceleration rule of section 6302(g) of the Code but the general rule of section 31.6302(c)-1(a)(1)(i) of the regulations.

C. REQUEST FOR COMMENTS

The taxes imposed by chapter 24 of the Code include amounts subject to the backup withholding provisions of section 3406 of the Code. The Service invites comments on whether amounts subject to backup withholding should continue to be taken into account in determining amounts subject to the deposit rules of section 6302(g) of the Code and section 31.6302(c)-1(a)(1)(i) of the regulations.

The Service is considering possible changes to the existing rules for the deposit of the taxes imposed by chapters 21 and 24, including but not limited to (a) the need for the 95 percent "safe-haven" exception in section 31.6302(c)-1(a)(1)(i) of the regulations, and (b) the possibility of replacing the eighth-monthly system with a less complex deposit system, such as one based on employers' payroll dates. The Service invites comments on these matters, including suggested alternatives to the current rules. Note, however, that alternatives should not significantly lengthen the time before payroll taxes are deposited.

V. PAYMENT OF UNDEPOSITED AMOUNTS AFTER NOTICE AND DEMAND

If the total employment tax liability for the quarterly return period has not been fully deposited by the due date of the quarterly Form 941, the Service will issue a notice and demand for the unpaid tax and the resulting penalties. As noted in Section II.B above, if the outstanding taxes are not paid by the tenth day following the date on which the notice was issued, the applicable failure-to-deposit penalty imposed by section 6656 of the Code rises to fifteen percent. To ensure that payment is properly credited to your account and to prevent the additional penalty charge, employers should follow these steps:

1. Submit a check or money order for the full amount billed;
2. Make the check or money order payable to Internal Revenue Service;
3. Attach the payment stub portion of the delinquency notice to the check or money order;
4. Use the envelope provided; and
5. Mail the payment within 10 days of the date on the notice.

VI. SUBMISSION OF COMMENTS

The Service invites comments with respect to matters discussed in

this notice. Comments should be addressed to the Assistant Chief Counsel (Income Tax & Accounting) Internal Revenue Service, 1111 Constitution Ave., N.W., Room 5134, Washington, D.C. 20224. Comments should be received by July 20, 1990, in order to ensure that they will receive full consideration.

Computer Generated Form 5300, 5307

Notice 90-38

1. BACKGROUND

Form 5300, Application for Determination for Employee Benefit Plan, is used by applicants requesting a determination letter for individually designed plans, other than collectively bargained plans. Form 5307, Application for Determination for Adopters of Master or Prototype, Regional Prototype or Volume Submitter Plans, is used by applicants requesting a determination letter for plans that have been preapproved by the Service for use of this form. Form 8717, User Fee for Determination Letter Request, is used to transmit the user fee that must accompany the application.

Page one of the Form 5300 series applications printed by the Service with a revision date after January 1, 1990, is printed in ink usable by optical character readers (OCRs). This page must be submitted in duplicate, and at least one of the duplicate copies must be an original printed in OCR ink. Therefore, applicants must ensure that they have a sufficient supply of original forms available. Further, entries must be made precisely in the areas provided on the application form or the reading equipment may misread the data, causing processing delays.

Instead of the preprinted forms, the Service will accept original copies of computer generated OCR data sheet attached to applications printed in black ink after determining that the requirements in this notice have been satisfied.

2. PURPOSE OF THIS NOTICE

This notice provides instructions for computer generation of OCR readable portions of Forms 5300 and 5307 (OCR data sheet). The original of the computer generated data sheet may be substituted for the OCR usable copy of the preprinted page one of these application forms. The balance of Form 5300 or 5307, i.e., one copy of pages 1 through 3, may be submitted in black ink, a photocopy (except the signature) is acceptable. If the balance of the application is also computer generated, it must be word-for-word and line-by-line identical to the preprinted application. This notice also provides instructions for computer generation of Form 8717, which may be substituted for the preprinted form only when filing Form 5307.

3. GENERAL INSTRUCTIONS

1. Software developers must submit test documents to the Service for approval and follow all the requirements in this notice. Upon approval, the Service will issue an acceptance number that will become an identifying number appearing at the top of the OCR data sheet and at the top of computer generated Form 8717.

2. After approval of the software, in submitting actual requests for determination letters to the key district offices, the instructions to Form 5300 or 5307 must be followed. For example, Form 5302 must be attached. However, the OCR data sheet may be substituted for one copy of the first page of the application.

3. Do not fold or staple the OCR data sheet. It may be paper clipped or spring clipped to the application.

4. SPECIFIC INSTRUCTIONS FOR FORMS 5300 and 5307

1. The OCR data sheet must be attached to a complete word-for-word identical copy of Form 5300 or Form 5307 that is signed and dated. This copy may be either a preprinted form, a photocopy, or a computer generated application, if approval of software has been received.

2. Each field, on the OCR usable page 1 must be bracketed by greater than & less than symbols.

3. Add at least two spaces before and after each greater than & less than symbol.

4. The greater than & less than symbols must be typed even if the data field is blank.

5. Use 10 pitch type.

6. Use 8 1/2 x 11 white bond, nonrecycled paper usable for printers & duplicating machines, 20 to 24 pounds. Do not use lightweight typing paper.

7. Set at least 1" margin at top, both sides, and bottom.

8. One line for each data field, except name fields 3, 9, and 27 (line 23 on form 5307) may be 2 lines, if needed.

9. Do not fold or staple OCR data sheet. Paper clip or spring clip to application.

10. Number each data field at left from 1 to 35 (1 to 32 on Form 5307).

11. At the top of the OCR data sheet, add the heading "Form 5300 (or 5307), OCR Data Sheet, Approval Number (insert approval number here, and on top of computer generated application, if applicable)."

Field Number		*Data Element* (must be bracketed)
Form 5300	*5307*	
1		5300
	1	5307
2	2	2/90
3	3	Name of plan sponsor up to 140 characters; may use 2 lines, if needed.

Field Number		*Data Element* (must be bracketed)
Form 5300	*5307*	
4	4	Employer Identification Number (nine digits).
5	5	Street Address of plan sponsor (or P.O. Box) up to 35 characters.
6	6	City in which plan sponsor is located, must be 3 to 20 characters.
7	7	Two digits representing state in which plan sponsor is located.
8	8	Zip code (5 or 9 digits) of plan sponsor, hyphen may be added.
9	9	Name of person to be contacted (including name on power of attorney) (blank, if none).
10	10	Address of person to be contacted (blank, if none).
11	11	City in which person to be contacted is located (blank, if none).
12	12	Two digits representing state in which person to be contacted is located (blank, if none).
13	13	Zip code of person to be contacted (blank, if none).
14	14	Enter "1" if initial qualification otherwise leave blank.
15	15	Enter "2" if amendment otherwise leave blank.
16		Enter "X" if plan is restated.
17		Enter "X" if plan is not restated.
	16	Enter "3" if standardized plan otherwise leave blank. In addition to this field, field 14 or 15 may also have an entry, if applicable.
18		Enter "3" if affiliated Service Group status is requested.
19		Enter "4" if leased employees are involved.
20		Enter "5" if a partial termination may have occurred.
21		Enter "X" if plan has received a determination letter.
	17	Enter "X" if plan has received such a determination letter dated after 1/1/84.
22	18	Enter "X" if plan has not received such a determination letter.
23	19	Enter "X" if interested parties were timely notified.
24	20	Enter "X" if interested parties were not timely notified.
25	21	Enter "X" if a 401(k) arrangement.
26	22	Enter "X" if not a 401(k) arrangement.
27	23	Name of Plan up to 70 characters, may use 2 lines, if needed.
28	24	Three digit plan number.
29	25	Four digits representing month and day in which plan year ends (MMDD).
30	26	Number of plan participants. Comma may be entered, if desired.
31	27	If defined benefit plan, enter 1,2,3 or 4.
32	28	If defined contribution plan, enter 1,2,3,4 or 5.
	29	Enter "1" if a member of an affiliated service group or enter "2" if not a member.
33		Enter "1" if a member of an affiliated service group; enter "2" if not a member, or enter "3" if not certain.
34	30	Enter "1" if a member of a controlled group or enter "2" if not a member.
	31	Enter "1" if a master or prototype plan; Enter "2" if regional prototype with a notification letter; Enter "3" if district approved volume submitter plan having an advisory letter.
	32	Enter "1" only if a government or church plan not subject to ERISA; otherwise enter "2".
35		Enter "1" if a government or church plan not subject to ERISA. Enter "2" if multiple employer plan. Enter "3" if other.

Example 1

Form 5300
OCR Data Sheet
Approval Number XXXXX

1. < 5300 >
2. < 2/90 >
3. < The Great Waldo Peanut Farming Company and Its Subsidiaries Worldwide, Incorporated >
4. < 123456789 >
5. < 156 Winding Road >
6. < Any Town >
7. < VA >
8. < 12345-6789 >
9. < The Best Law Firm >
10. < 123 Fifth Street >
11. < Any Town >
12. < VA >

Example 1 cont.

13. < 12345-6789 >
14. < >
15. < 2 >
16. < X >
17. < >
18. < 3 >
19. < 4 >
20. < 5 >
21. < X >
22. < >
23. < X >
24. < >
25. < X >
26. < X >
27. < The Great Waldo Trucking Retirement Plan >
28. < 001 >
29. < 0131 >
30. < 502 >
31. < >
32. < 1 >
33. < 2 >
34. < 1 >
35. < 3 >

Example 2

Form 5307
OCR Data Sheet
Approval Number XXXXX

1. < 5307 >
2. < 2/90 >
3. < The Great Waldo Peanut Farming Company and Its Subsidiaries Worldwide, Incorporated >
4. < 123456789 >
5. < 156 Winding Road >
6. < Any Town >
7. < VA >
8. < 12345-6789 >
9. < The Best Law Firm >
10. < 123 Fifth Street >
11. < Any Town >
12. < VA >
13. < 12345-6789 >
14. < >
15. < 2 >
16. < >
17. < X >
18. < >
19. < X >
20. < >
21. < >
22. < X >
23. < The Great Waldo Trucking Retirement Plan >
24. < 001 >
25. < 0131 >
26. < 502 >
27. < >
28. < 1 >
29. < 2 >
30. < 1 >
31. < 3 >
32. < 2 >

5. *SPECIFIC INSTRUCTIONS for FORM 8717 Only As An Attachment To Form 5307*

1. Each data element except data elements 6 (Form Number), 7 (Revision date), 8 (control #) and 9 (User Fee Screener) must be bracketed by greater than & less than symbols.

2. Use 10 pitch type.

3. Use 8 1/2 x 11 paper white bond nonrecycled paper usable with printers and duplicating machines.

4. Set at least 1" margin at top, both sides, and bottom.

5. One line for each data element, may be double spaced if desired. Data element 2 (Employer Name) may be 2 lines, if needed.

6. Do not fold or staple OCR usable form. Paper clip or spring clip to application.

7. Number each data field at left from 1 to 9.

8. At top of form add the heading "Substitute for Form 8717" and include the approval number.

Element Number	*Data Element*
1.	Attachment to Form Number <5307>
2.	ER Name <Enter name of employer adopting this plan>
3.	Plan Number <Enter 3 digit plan number>
4.	Payer <Enter name of payer of check for user fee>
5.	Fee <enter appropriate fee $100 or $125>
6.	Form Number 8717 (Not bracketed)
7.	Rev. Date 189 (Not bracketed)
8.	Control # _____ (Not bracketed)
9.	User Fee Screener _____ (Not bracketed)

Example 3

Substitute for Form 8717
Approval Number XXXXX

1. Attachment to Form Number <5307>
2. ER Name <Great Waldo Peanut Farming Co.>
3. Plan Number <001>
4. Payer <The Crew Waldo Peanut Farming Co.>
5. Fee <100>
6. Form Number 8717
7. Rev. Date 189
8. Control # _____
9. User Fee Screener _____

6. ACCEPTANCE

Persons interested in filing computer generated applications described in this notice must obtain prior approval of both their software and printer(s) from the Service.

On or before August 1, 1990, written approval must be obtained from the National Office of the Service. After August 1, 1990, written approval must be obtained from the key district office for employee plans matters that will receive the majority of the applications, or, if for applications that will be used nationwide, the National Office of the Service at the following addresses:

7. *Region*	*Contact Point After August 1, 1990*
Central	Volume Submitter Coordinator, Room 4122 Internal Revenue Service (EP/EO) P.O. Box 2508, Cincinnati, Ohio 45201
Mid-Atlantic	Volume Submitter Coordinator, Room 716 Internal Revenue Service (EP/EO) P.O. Box 13163, Baltimore, MD 21203
Midwest	Volume Submitter Coordinator, DPN 22-1 Internal Revenue Service (EP/EO) 230 S. Dearborn St. Chicago, IL 60604
North Atlantic	Chief, Review Staff Internal Revenue Service (EP/EO) P.O. Box C-9076 Brooklyn, NY 11202
Southeast	Chief, Review Staff Internal Revenue Service (EP/EO) P.O. Box 1055 Stop 516D Atlanta, GA 30370

Region	*Contact Point After August 1, 1990*
Southwest	Volume Submitter Coordinator Internal Revenue Service (EP/EO) 1100 Commerce Street Mail Code 4919 DAL Dallas, TX 75242
Western	Volume Submitter Coordinator Room 5127 Internal Revenue Service (EP/EO) P.O. Box 2350 Los Angeles, CA 90053
National Office	Chief, EP/EO Determination Branch E:O:D Room 2235 attn: WLM Internal Revenue Service 1111 Constitution Ave., NW Washington, DC 20224
	Contact Point Before August 1, 1990
All Regions	Chief EP/EO Determination Branch E:O:D Room 2235 Attn: WLM Internal Revenue Service 1111 Constitution Ave., NW Washington, DC 20224

8. TESTING AND ACCEPTANCE

General

The make and model of the printer being used must be identified, along with the printing font, e.g. pica or courier. Only printers and fonts approved by the Service may be used.

All accepted software will receive an approval number. This number must appear at the top of the OCR data sheet and the substitute for Form 8717, if any.

Forms 5300 and 5307

Test documents consisting of the OCR data sheet and the balance of the application, i.e., pages one to three of Form 5300 or 5307 (whether computer generated or not) must be submitted for approval. Separate test documents must be submitted for each type of plan, e.g. profit sharing, fixed benefit, flat benefit, etc. The applications must reflect accurate plan data. However, employer and plan names, employer identification numbers, and other identifying data may be fictitious. Separate test applications must include data based on the assumption that the employer maintains another plan, and on the assumption that no other plan is being maintained.

Form 8717

Separate test documents must be submitted reflecting the appropriate user fee for Form 5307 applications being submitted, both before October 1, 1990, and after September 30, 1990, see Rev. Proc. 90-17, page 479, this Bulletin.

9. ADVERTISING STANDARDS

A. Advertising Restrictions

Taxpayer preparers shall comply with the advertising and solicitation provisions of 31 C.F.R. Part 10 (Treasury Department Circular No. 230). Such provisions prohibit the use in any way or participation in the use of any form of public communication containing a false, fraudulent, misleading, deceptive, unduly influencing, coercive or unfair statement or claim. The prohibition includes, but is not limited to, statements pertaining to the quality of services rendered unless subject to factual verification, claims of specialized expertise not authorized by State or Federal agencies having jurisdiction over the preparer, and statements or suggestions that the ingenuity and/or prior record of a preparer rather than the merit of the matter are principal factors likely to determine the result of the matter. In addition, advertising must not imply a special relationship with the Internal Revenue Service (IRS) or the Treasury Department.

B. *Endorsement*

Acceptance to participate in the program is not, and does not imply endorsement by the Internal Revenue Service of the software or quality of the services provided. Therefore, any public communication in which a participant's capabilities are referenced, whether through publication or broadcast, must clearly indicate that IRC acceptance of the participant does not constitute an endorsement of approval of the quality of tax preparation services provided.

Weighted Average Interest Rate Update

Notice 90-39

Notice 88-73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of section 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 (OBRA 1987).

The notice also provides that an announcement will be published monthly to provide the weighted average and the permissible range for the plan years beginning each month. The following rates were determined for the plan years beginning each month. The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	Permissible Range
May	1990	8.57	7.71 to 9.43

Administrative Pronouncement

This document serves as an "administrative pronouncement" as that term is described in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

Revisions to §301.6114-1(c)(7) and (d)

Notice 90-40

The Internal Revenue Service today announced that certain additional rules will be incorporated in section 301.6114-1(c)(7) and (d) of the final regulations under section 6114 of the Internal Revenue Code. These regulations relate to the requirement that any taxpayer who takes a position that a treaty of the United States overrules, or otherwise modifies, an internal revenue law of the United States must disclose such position. The existing final regulations were published in the Federal Register for Wednesday, March 14, 1990, at 54 FR 9438 [page 180, this Bulletin].

Pursuant to section 6114(b) of the Code, with respect to policies issued by foreign insurers, reporting that a treaty exempts the taxpayer from the excise tax imposed by section 4371 will be waived under section 6114 for both—

(1) An insured, as defined in section 4372(d), and

(2) A U.S. or foreign broker of insurance risks.

This reporting will not be waived, however, in the case of a foreign insurer or reinsurer, as defined in section 4372(a). Therefore, subject to the conditions of section 301.6114-1(c)(7) of the regulations, these foreign insurers and reinsurers must report under section 6114.

For purposes of reporting under section 301.6114-1(d)(4) of the regulations, all premiums on—

(1) Casualty insurance and indemnity bonds (subject to section 4371(1)),

(2) Life insurance, sickness and accident policies, and annuity contracts (subject to section 4371(2)), or

(3) Reinsurance (subject to section 4371(3)),

paid by above described insureds with respect to each of the foregoing categories may be treated as a single payment or income item within that category.

For reports with respect to payments of insurance made during calendar years 1988, 1989 and 1990, such reports may disclose, under section 301.6114-1(d)(4)(i), for each of the three categories set forth above, the total amount of premiums derived by a foreign insurer or reinsurer in U.S. dollars (even if a portion of these premiums relate to risks that are not U.S. situs). As is the general rule, reasonable estimates of the amounts required to be disclosed will satisfy these reporting requirements. Foreign insurers and reinsurers must report for calendar years 1988 and 1989 no later than August 15, 1990.

The foregoing rules, when incorporated in final regulations, will apply to taxable years of the taxpayer for which the due date for filing returns (without extensions) occurs after December 31, 1988.

This document serves as an "administrative pronouncement" as that term is used in section 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

EFFECT ON OTHER DOCUMENTS

Sections 301.6114-1(c)(7) and 301.6114-1(d) will be modified.

Partnerships and Section 514(c)(9)

Notice 90-41

I. PURPOSE

This notice provides guidance regarding the application of section 514(c)(9)(E) of the Internal Revenue Code to certain partnerships in which one or more (but not all) of the partners are qualified tax-exempt organizations within the meaning of section 514(c)(9)(C). Specifically, this notice provides guidance regarding (1) reasonable preferred returns and guaranteed payments that will be permitted pursuant to regulations that will be issued under section 514(c)(9)(E)(ii)(II), and (2) regulations that will be issued under section 514(c)(9)(E)(iii) to carry out the purposes of section 514(c)(9)(E), including regulations excluding certain items from the determination of whether the requirements of section 514(c)(9)(E) are satisfied. More complete guidance will be provided in regulations.

II. BACKGROUND

Under section 511 of the Code, tax-exempt organizations are generally taxable on their unrelated business taxable income (as defined in section 512). Section 514(a) generally provides that in computing unrelated business taxable income there shall be included as an item of gross income an amount that is a specified percentage of the total gross income derived from or on account of debt-financed property. However, section 514(c)(9) provides an exception to the debt-financed income rules for certain debt-financed investments in real property made by tax-exempt organizations described in section 514(c)(9)(C) ("qualified organizations"). Qualified organizations include only educational organizations described in section 170(b)(1)(A)(ii) and their affiliated support organizations, and qualified trusts described in section 401. (Although the definition of qualified organizations also includes, in effect, any of the foregoing organizations to the extent of their interests in property-holding organizations described in section 501(c)(25), the flush language of section 501(c)(25)(A) precludes such property-holding organizations from making the types of partnership investments described in section 514(c)(9) and in this notice, because that language prohibits indirect interests in real property.) If the requirements of section 514(c)(9) are satisfied, the income derived by the qualified organization from debt-financed real property is not subject to taxation as unrelated business income.

In addition to the basic requirements that must be satisfied for the exception provided by section 514(c)(9) to apply, special rules apply in the case of debt-financed real property held by a partnership in which one or more (but not all) of the partners are

qualified organizations. Under these rules, either (1) each allocation to a partner that is a qualified organization must be a "qualified allocation" (within the meaning of section 168(h)(6)) or (2) the partnership must satisfy the requirements of section 514(c)(9)(E). This notice provides guidance regarding the requirements of section 514(c)(9)(E).

Section 514(c)(9)(E) was added to the Code by section 10214 of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, and was subsequently amended by section 2004(h) of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647. Under section 514(c)(9)(E)(i) of the Code, a partnership satisfies the requirements of section 514(c)(9)(E) if:

(I) The allocation of items to any partner that is a qualified organization cannot result in that partner having a share of overall partnership income for any taxable year greater than that partner's share of overall partnership loss for the taxable year for which that partner's loss share will be the smallest (the "fractions rule"), and

(II) Each allocation with respect to the partnership has substantial economic effect within the meaning of section 704(b)(2).

For example, if a qualified organization is allocated 30 percent of overall partnership loss for year 1, 25 percent of overall partnership loss for year 2, and 20 percent of overall partnership loss for year 3 and all later years, the partnership allocations will violate the fractions rule if the qualified organization may be allocated more than 20 percent of overall partnership income for any taxable year.

For purposes of the fractions rule, the items of partnership income, gain, loss, and deduction that are taken into account are the items of income, gain, loss, and deduction as computed for purposes of maintaining the partners' capital accounts under section 1.704-1(b)(2)(iv) of the regulations. As a result, tax items allocated under section 704(c) are disregarded for purposes of applying the fractions rule. See also part V of this notice, below, regarding allocations that cannot have substantial economic effect.

Section 514(c)(9)(E)(ii) contains special rules regarding the tax treatment of certain chargebacks, preferred rates of return, and guaranteed payments. To the extent provided in regulations issued under section 514(c)(9)(E)(ii)(II), a partnership may provide for reasonable preferred returns or reasonable guaranteed payments without violating the requirements of section 514(c)(9)(E). See part III of this notice, below. In addition, section 514(c)(9)(E)(iii) grants the Treasury Department the authority to prescribe such regulations as may be necessary to carry out the purposes of section 514(c)(9)(E), including regulations that may provide for the exclusion or segregation of items. See parts IV, V and VI of this notice, below. If an item is excluded from the application of the fractions rule, the item is not taken into account in determining whether the fractions rule has been satisfied. In other words, if the allocation of an item of income or deduction to a qualified organization is excluded by regulation from the application of the fractions rule, the allocation of this item to the qualified organization will not be taken into account in determining the organization's share of overall partnership income or loss for the year.

III. PREFERRED RETURNS AND GUARANTEED PAYMENTS

A. General Rule

Generally, a qualified organization may not be allocated a disproportionately high share of partnership income (i.e., a share of overall partnership income for a taxable year that exceeds its lowest share of overall partnership loss for any taxable year) without violating the requirements of section 514(c)(9)(E). Section 514(c)(9)(E)(ii)(II), however, permits a partnership, to the extent allowed by regulation, to provide for reasonable preferred returns or reasonable guaranteed payments without violating the requirements of the general rule of section 514(c)(9)(E).

The Internal Revenue Service will issue regulations under section 514(c)(9)(E)(ii)(II) establishing rules for determining whether a preferred return or guaranteed payment to a qualified organization is reasonable, and whether income that is allocated to support a reasonable preferred return or income that is accrued with respect to a reasonable guaranteed payment is taken into account in applying the fractions rule. The regulations will not provide special rules dealing with preferred returns or guaranteed payments payable to partners other than qualified organizations because the fractions rule does not limit the amount of income that may be allocated to such other partners. For purposes of this notice, the term "preferred return" means a partner's right to a preferential distribution of cash flow with respect to capital contributed to the partnership by the partner which will be matched, to the extent available, by an allocation of income or gain from operations or the sale of assets, and the term "guaranteed payment" means any payment to a partner that is described in section 707(c).

The regulations that will be issued under section 514(c)(9)(E)(ii)(II) will provide as follows:

(1) For purposes of determining whether the partnership satisfies the fractions rule, an allocation to a qualified organization of partnership gross or net income to support the payment to the organization of a reasonable preferred return for capital is disregarded only to the extent that the amount of income so allocated will not exceed the excess of actual distributions made to the organization in satisfaction of the preferred return during the current and all prior taxable years over the partnership income previously allocated to the organization to support the payment of the preferred return.

(2) For purposes of determining whether the partnership satisfies the fractions rule, any income of a qualified organization from reasonable guaranteed payments during a partnership taxable year is disregarded only to the extent that the guaranteed payment that accrues for each partnership taxable year will actually be paid during that year. See section 1.461-1(a)(2) of the regulations and paragraph (3) of this part III.A. For purposes of this notice, a guaranteed payment accrues as the partnership takes that payment into account as paid or accrued under its method of accounting.

(3) For purposes of paragraphs (1) and (2) of this part III.A, any distribution or payment made by the partnership to a partner in satisfaction of a preferred return or guaranteed payment, as the case may be, within 75

days after the end of a partnership taxable year may be treated by the partnership as a distribution or payment made on the last day of that year.

(4) The regulations will provide that a preferred return or guaranteed payment is reasonable only if it meets the requirements specified in part III.B. (reasonable preferred returns and guaranteed payments for capital) or part III.C. (reasonable guaranteed payments for services) of this notice.

B. Reasonable Preferred Returns and Guaranteed Payments for Capital

For purposes of this notice, a preferred return or guaranteed payment for capital that is paid to a qualified organization is reasonable only if the following requirements are satisfied:

(1) The terms of the preferred return or guaranteed payment for capital are set forth in a written partnership agreement.

(2) The preferred return or guaranteed payment that is payable to a qualified organization for any period (not to exceed one year) may not exceed the amount determined by multiplying the qualified organization's unreturned capital (plus any unpaid preferred return or guaranteed payment for capital that is payable to the qualified organization for prior periods) at the beginning of the period by the maximum acceptable interest rate for that period. The maximum acceptable interest rate for a period equals 120 percent of the highest applicable federal rate in effect at any time beginning on or after the time that the right to the preferred return or guaranteed payment is first established pursuant to a binding, written agreement among the partners and ending at the beginning of that period. For this purpose, the highest applicable federal rate is the highest of the federal short-term, mid-term, or long-term rate described in section 1274(d) of the Code, appropriately adjusted for the length of the period and the period of compounding.

(3) A qualified organization's unreturned capital equals the excess of the aggregate amount of money and the fair market value of other property contributed by the qualified organization to the partnership (net of liabilities secured by that property that the partnership is considered to assume or take subject to under section 752 and the regulations thereunder) over the aggregate amount of money and the fair market value of other property distributed by the partnership to the qualified organization (net of liabilities secured by the property that the qualified organization is considered to assume or take subject to under section 752 and the regulations thereunder) that constitutes a return of the qualified organization's capital taking into account all of the facts and circumstances, including the terms of the partnership agreement that provide for the distribution. Generally, a distribution shall be treated as a return of a qualified organization's capital contribution if it constitutes a material distribution that is not attributable to the partnership's cash flow from its business operations, or if the distribution otherwise constitutes a return of contributed capital under the partnership agreement. The Service will closely scrutinize the value assigned to property contributed by any qualified organization (or distributed by the partnership to any qualified organization) that is entitled to a preferred return or guaranteed payment.

The following examples illustrate the foregoing rules. For simplicity, the examples consider only the case of a preferred return.

Example (1). (i) T, a taxable real estate developer, and Q, a qualified organization, form a partnership to construct and operate an office building. T contributes $10x and Q contributes $90x to the partnership. The partnership will borrow additional amounts to construct the office building. The partnership agreement provides that operating cash flow of the partnership will be distributed first, pro rata, to provide each partner with a preferred return on unreturned capital (within the meaning of part III.B.(3) of this notice), and thereafter 50 percent to T and 50 percent to Q. The preferred return that is payable to each partner for each partnership taxable year is determined by multiplying the partner's unreturned capital (plus any unpaid preferred return) by 120 percent of the highest applicable federal rate in effect at any time on or after the formation of the partnership. The partnership agreement also provides that net income will be allocated first, pro rata, to offset prior allocations of loss; then, 10 percent to T and 90 percent to Q, to the extent necessary to support any distributions made to the partners in satisfaction of the preferred return in the current and in all prior taxable years; and, last, 50 percent to T and 50 percent to Q. Partnership net taxable loss will be allocated 50 percent to T and 50 percent to Q. The allocations required under the partnership agreement have substantial economic effect within the meaning of section 704(b) and the regulations thereunder.

(ii) Under the rules of this notice, the preferred return payable to Q constitutes a reasonable preferred return, and the allocation of income to support this preferred return will be disregarded in applying the fractions rule. As a result, Q's highest share of overall partnership income for any taxable year is 50 percent, not 90 percent. Accordingly, because 50 percent is not greater than Q's smallest share of overall partnership loss for any taxable year (50 percent), the partnership allocations satisfy the fractions rule.

Example (2). The facts are the same as in Example (1), except that the preferred return on each partner's unreturned capital is 200 percent of the highest applicable federal rate in effect at any time on or after the formation of the partnership. Income allocated to support this preferred return will not be disregarded in applying the fractions rule. Accordingly, since Q's highest share of overall partnership income for any taxable year (90 percent) is greater than its smallest share of overall partnership loss for any taxable year (50 percent), the partnership allocations do not satisfy the fractions rule.

Example (3). The facts are the same as in Example (2), except that the partnership agreement allocates net loss 10 percent to T and 90 percent to Q throughout the life of the partnership. Again, income allocated to support the preferred return will not be disregarded in applying the fractions rule. Nevertheless, because Q's highest share of overall partnership income for any taxable year (90 percent) is not greater than its smallest share of overall partnership loss for any taxable year (90

percent), the partnership allocations satisfy the fractions rule.

C. Reasonable Guaranteed Payments for Services

For purposes of this notice, a guaranteed payment for services that is payable to a qualified organization is reasonable only if such payment is reasonable in amount under the rules of section 1.162-7 of the regulations (relating to the deduction for payment of personal services). A determination, however, that such a guaranteed payment is reasonable for purposes of section 514(c)(9)(E) does not affect whether that payment constitutes unrelated business taxable income to the qualified organization under other provisions of the Code.

IV. EXCLUSION OR SEGREGATION OF PARTNERSHIP ITEMS

Generally, in order for a partnership to satisfy section 514(c)(9)(E) of the Code: (1) the allocation of items to a qualified organization must comply with the fractions rule of section 514(c)(9)(E)(i)(I); and (2) each partnership allocation must have substantial economic effect as set forth in section 704(b)(2). The fact that a particular allocation is required by section 704(b) will not preclude such allocation from violating the fractions rule. Thus, if an allocation that is respected for tax purposes under section 704(b) violates the limitations of the fractions rule, the allocation will cause the partnership to fail the requirements of section 514(c)(9)(E) unless the regulations thereunder provide otherwise.

As stated above, the fractions rule provides that the allocation of items to any partner that is a qualified organization cannot result in that partner having a share of the overall partnership income for any taxable year greater than the partner's share of the overall partnership loss for the taxable year for which the partner's share of loss will be the smallest. Under section 514(c)(9)(E)(iii), however, the Treasury Department has been granted the authority to prescribe regulations that permit the exclusion or segregation of items. An item excluded from the application of the fractions rule is not taken into account in determining whether the fractions rule has been satisfied.

The legislative history of section 514(c)(9)(E) indicates that the Treasury Department's authority to exclude certain items from the application of the fractions rule must be exercised in a manner that is consistent with the purpose of that section that is, to limit the transfer of tax benefits from tax-exempt partners to taxable partners. H.R. Rep. No. 795, 100th Cong., 2d Sess. 404 (1988); Report on the Technical Corrections Act of 1988, S. Rep. No. 445, 100th Cong., 2d Sess. 428 (1988). The transfer of tax benefits to taxable partners that the fractions rule is intended to prevent could otherwise occur either by directing income to tax-exempt partners or by directing losses and deductions to taxable partners. Accordingly, the regulations will not exclude allocations that are designed to shift tax benefits to taxable partners.

In general, the regulations will exclude from the determination of whether the fractions rule is satisfied any allocation for a partnership taxable year of items of loss or deduction (other than nonrecourse deductions, within the meaning of section 1.704-1T(b)(4)(iv) (or, if applicable, section 1.704-1(b)(4)(iv)) of the regulations) that may be made to partners other than qualified organizations only if—

(1) Under the partnership agreement, the allocation will be made only after no partner that is a qualified organization has a positive capital account balance (as determined and maintained in accordance with section 1.704-1(b)(2)(iv));

(2) The partnership has a partnership net taxable loss for the year, and the allocation will not exceed the amount of that loss; and

(3) At the time that the provision requiring the allocation becomes part of the partnership agreement, it is unlikely that such an allocation will be made.

This exclusion is referred to below as the Unlikely Allocation Exclusion. For purposes of the Unlikely Allocation Exclusion, the term "partnership net taxable loss" means, for any partnership taxable year, the amount by which the aggregate partnership items of loss, deduction, and section 705(a)(2)(B) expenditure for the year (other than items that are treated as nonrecourse deductions within the meaning of section 1.704-1T(b)(4)(iv) or, if applicable, section 1.704-1(b)(4)(iv) of the regulations) exceed the aggregate partnership items of income and gain (including tax-exempt income) for the year (other than items allocated pursuant to a minimum gain chargeback in accordance with section 1.704-1T(b)(4)(iv)(e) or, if applicable, section 1.704-1(b)(4)(iv)(e) of the regulations).

All the facts and circumstances must be taken into account in determining whether the Unlikely Allocation Exclusion applies. For purposes of this rule, an allocation made pursuant to a provision in the partnership agreement is considered unlikely only if all of the information (including bona fide financial projections) available to the partners at the time the provision requiring the allocation becomes part of the partnership agreement reasonably indicates that it is more likely than not that the allocation will not be made. All possible events that could occur must be taken into account in determining whether an allocation is unlikely; an allocation will be considered unlikely if the allocation will be made only as a result of any event or combination of events that the parties reasonably believe will not occur. These types of events include, for example, tort losses in excess of insurance; unforeseen third-party litigation, strikes, or delays in securing required permits and licenses; abnormal weather conditions (considering the season and the job site); a significant delay in leasing the property due to an economic downturn in the geographic area; and unanticipated cost overruns. On the other hand, an allocation attributable to one or more expenditures will not be considered unlikely to the extent that an allowance for the expenditures (e.g., insurance for a tort liability or an allowance for cost overruns) was or reasonably should have been included in the financial projections for, and in the provisions for funding of, the project. The fact that the partnership agreement provides for an allocation does not, in and of itself, imply that an allocation is likely to be made pursuant to that provision.

The regulations also will provide that upon the occurrence of an "extraordinary partnership event" the Unlikely Allocation Exclusion will continue to apply to an allocation

only if, immediately after such event, it is still reasonable to believe that the allocation is unlikely to be made. In other words, the allocation will be retested to determine whether it satisfies the Unlikely Allocation Exclusion at the time of the extraordinary partnership event. An event is an extraordinary partnership event only if the event is within the control of the partnership (or its partners) and involves a material change in the capital of the partnership resulting from a contribution to the partnership by one or more partners, or a distribution by the partnership to one or more partners. For example, a material distribution of the proceeds of a refinancing will constitute an extraordinary partnership event. Similarly, a material disposition of partnership property and the distribution of the proceeds to the partners will constitute an extraordinary partnership event, if the disposition is within the control of the partnership (or its partners).

In addition to the Unlikely Allocation Exclusion, the regulations will exclude from the determination of whether the fractions rule is satisfied any allocation that may be made pursuant to a qualified income offset within the meaning of section 1.704-1(b)(2)(ii)(d) of the regulations because a qualified income offset is—by its terms—triggered only by certain unexpected events specified in such regulations.

The following examples illustrate the application of the Unlikely Allocation Exclusion. In each example, the partnership agreement provides that the partners' capital accounts will be determined and maintained in accordance with section 1.704-1(b)(2)-(iv) of the regulations; that distributions in liquidation of the partnership (or of any partner's interest) will be made in accordance with the partners' positive capital account balances (as set forth in section 1.704-1(b)(2)(ii)(b)-(2)); that T will be required to restore any deficit balance in T's capital account following the liquidation of T's interest (as set forth in section 1.704-1(b)(2)(ii)(b)(3)); and that Q will not be required to restore any deficit balance in Q's capital account following the liquidation of Q's interest. The partnership agreement contains a minimum gain chargeback provision (in accordance with section 1.704-1T(b)(4)(iv)(e)). In addition, the partnership agreement contains a qualified income offset (as defined in section 1.704-1(b)(2)(ii)(d)), and, as of the end of each taxable year discussed herein, the items described in sections 1.704-1(b)(2)(ii)(d)(4), (5), and (6) are not reasonably expected to cause or increase a deficit balance in Q's capital account.

Example (1). (i) T, a taxable real estate developer, and Q, a qualified organization, form a partnership to construct and operate an office building. T contributes $10x and Q contributes $90x. The partnership obtains a nonrecourse loan commitment of $300x to provide the additional financing that, according to financial projections, will be required to fund construction costs, start-up costs, and reserves. The partnership agreement allocates net income first, pro rata, to offset prior allocations of loss and distributions of operating cash flow, and then 50 percent to T and 50 percent to Q. The partnership agreement allocates all partnership net taxable loss (as defined in this section IV) 10 percent to T and 90 percent to Q, except that after Q's capital account has been reduced to zero all partnership net taxable loss will be allocated entirely to T. The partnership agreement allocates nonrecourse deductions (within the meaning of section 1.704-1T(b)(4)(iv) or, if applicable, section 1.704-1(b)(4)(iv) of the regulations) 10 percent to T and 90 percent to Q. Bona fide financial projections reasonably indicate that at the time the partnership agreement is executed it is unlikely that the partnership will incur a partnership net taxable loss after Q's capital account has been reduced to zero. Operating cash flow will be distributed 10 percent to T and 90 percent to Q until the partnership has earned net income equal to prior net losses, after which time operating cash flow will be distributed 50 percent to T and 50 percent to Q. The terms of this partnership agreement satisfy the requirements of the fractions rule and section 704(b)(2).

(ii) After completion of the office building and several years of operations, the partnership incurs an unanticipated tort loss (in excess of reasonable insurance) of $30x, and incurs a partnership net taxable loss for the year of $25x. The partnership funds the payment of this liability with a capital contribution of $30x by T. Immediately after T's additional $30x capital contribution and before allocation of the partnership's net taxable loss for the year, T's positive capital account balance equals $32x and Q's positive capital account balance equals $18x. Under the partnership agreement, net taxable loss for the taxable year must first be allocated 10 percent to T and 90 percent to Q until Q's capital account has been reduced to zero, with any remaining partnership net taxable loss being allocated entirely to T. Therefore, the first $20x of the $25x net taxable loss for the year is allocated $18x to Q and $2x to T, and the remaining $5x of partnership net taxable loss is allocated to T.

(iii) In determining whether the partnership's allocations satisfy the fractions rule, the allocation made pursuant to the provision in the partnership agreement requiring all partnership net taxable loss to be allocated to T after Q's capital account has been reduced to zero will be disregarded under the Unlikely Allocation Exclusion. This allocation is excluded from the application of the fractions rule because all of the information available at the time that the partnership agreement is executed reasonably indicates that it is more likely than not that no allocation will be made pursuant to that provision. The fact that an allocation is actually made pursuant to the provision as a result of unexpected events does not affect the applicability of the exclusion if such an allocation was unlikely at the time the provision was included in the partnership agreement. Accordingly, the Unlikely Allocation Exclusion continues to apply even after $5x of partnership net taxable loss is allocated to T under the excluded allocation provision. The allocation provision does not have to be tested again at the time it becomes operable because the event that triggered the provision (the unanticipated tort loss) is not an extraordinary partnership event.

(iv) The conclusion reached in this example would be the same if, instead of T's making a capital contribution of $30x, the partnership funded the payment of the tort liability through a $30x recourse loan obtained from an unrelated lender.

(v) The conclusion reached in this example does not depend on the tort nature of the event giving rise to the unlikely loss allocation. This is because, as stated in paragraph (i) of this example, the partnership could demonstrate that, at the time the allocation provision became part of the partnership agreement, all of the information available reasonably indicated that it was more likely than not that no allocation would be made pursuant to that provision. By contrast, the partnership could not make this showing to the extent that, for example, its projections at the time the partnership was formed failed to include a reasonable allowance for events which, in the aggregate, are likely to occur.

Example (2). (i) The facts are the same as in Example (1), except that the partnership does not incur an unanticipated tort loss. After several years of operations, T has a positive capital account balance of $3x and Q has a positive capital account balance of $27x. At this time, the partnership borrows from an unrelated bank an additional $30x, on a recourse basis, and distributes the proceeds $3x to T and $27x to Q, thus reducing the capital account balances to zero. In the following year, the partnership incurs a partnership net taxable loss of $10x. The entire $10x of partnership net taxable loss is allocated to T under the partnership agreement.

(ii) The distribution of loan proceeds to T and Q constitutes an extraordinary partnership event. Accordingly, after the distribution of the loan proceeds, the Unlikely Allocation Exclusion will continue to apply to the allocation provision in the partnership agreement requiring all partnership net taxable loss to be allocated to T after Q's capital account has been reduced to zero only if immediately after the distribution of the loan proceeds it is still unlikely that an allocation will be made pursuant to that provision. Otherwise, the fractions rule will not be satisfied after the distribution of the loan proceeds.

V. ALLOCATIONS THAT CANNOT HAVE SUBSTANTIAL ECONOMIC EFFECT

Section 514(c)(9)(E)(i)(II) requires that allocations must have substantial economic effect within the meaning of section 704(b)(2). The regulations will provide that allocations will be deemed to have substantial economic effect for this purpose if the allocations cannot have substantial economic effect but are deemed to be in accordance with the partners' interests in the partnership under section 1.704–1T(b)(4)(iv) (or, if applicable, section 1.704–1(b)(4)(iv)) of the regulations. This category includes allocations of tax credits; allocations of deduction and loss (including minimum gain chargebacks) attributable to nonrecourse debt; and allocations of percentage depletion in excess of basis. This category also includes allocations made under section 704(c) as a result of a contribution of property to the partnership, or any allocations made in the same manner as under section 704(c) in connection with a revaluation of partnership property pursuant to sections 1.704–1(b)(2)(iv)(f) or (r). The regulations will require the allocations described in this paragraph to comply both with section 1.704–1(b)(4)(iv) (or, if applicable, section 1.704–1T(b)(4)(iv)) and with the relevant Code or regulations section that governs the particular allocation.

VI. SPECIAL RULES

The regulations will disregard a change in the allocations (including allocations required by the varying interests rules of section 706(d) and allocations arising from basis adjustments under section 743(b)) made to a qualified organization in connection with either (1) the acquisition, transfer, or liquidation of all or a part of an interest in the partnership; or (2) the default of a partner (other than a prearranged default) under the terms of the partnership agreement. Such a change in allocations will be disregarded, however, only if: (1) the transaction which gives rise to the change is the result of arm's-length dealing or has the same result as would have occurred in an arm's-length dealing (i.e., based on fair market value at the time of the transaction); (2) the allocations (other than allocations excluded by section 514(c)(9)(E) or this notice) that may be made under the partnership agreement after the change satisfy the fractions rule; and (3) the change does not have the principal effect of avoiding the restrictions of section 514(c)(9)(E) or the regulations thereunder.

In addition, the allocation provisions in the partnership agreement need not satisfy the fractions rule until the first year in which the partnership incurs debt.

VII. EFFECTIVE DATE

As amended, section 514(c)(9)(E) of the Code applies generally to property acquired by partnerships after October 13, 1987, and to partnership interests acquired after October 13, 1987. See Pub. L. No. 100–203, section 10214(c), and Pub. L. No. 100–647, section 2004(u). Regulations to be issued under section 514(c)(9)(E) will provide that the rules described in this notice will be applicable as of June 25, 1990.

In view of this effective date, the regulations will treat a partnership agreement as if it satisfied the requirements of section 514(c)(9)(E) for the period beginning after October 13, 1987, and ending on June 25, 1990, if during that period the partnership's allocations would have satisfied the requirements of section 514(c)(9)(E) (as described in this notice) if this notice had been effective on October 13, 1987.

Moreover, an amendment to a partnership agreement to provide for a preferred return or guaranteed payment to a qualified organization for any period after June 25, 1990, will be disregarded in determining whether the partnership's allocations satisfy the fractions rule if: (1) the allocations (other than allocations excluded by section 514(c)(9)(E) or this notice) made under the partnership agreement before this amendment satisfy the fractions rule; and (2) the allocations (other than allocations excluded by section 514(c)(9)(E) or this notice) that may be made under the partnership agreement after this amendment satisfy the fractions rule.

VIII. REQUEST FOR COMMENT ON FUTURE GUIDANCE

The Service is considering adopting rules similar to those set forth in this notice in regulations to be issued under the "tax-exempt entity leasing" rules of section 168(h)(6) of the Code.

In addition, consideration is being given to adopting a de minimis rule pursuant to the authority granted in section 514(c)(9)(E)(iii). For example,

the regulations could provide that the fractions rule will be deemed to be satisfied for partnerships in which partners other than tax-exempt organizations hold 98 percent of the interests in partnership capital, if the exempt partners participate on substantially the same terms as the taxable partners and if the principal purpose of the allocations is not tax avoidance.

The Service is also studying the appropriate treatment of chargebacks with respect to disproportionate losses previously allocated to qualified organizations and to disproportionate income previously allocated to other partners, as described in section 514(c)(9)(E)(ii)(I).

The Service invites public comment on these issues, as well as comments generally on this notice and on issues arising under other paragraphs of section 514(c)(9).

Ozone-Depleting Chemicals Tax: Erroneous Refunds

Notice 90-42

This Notice informs the public of what actions to take if a refund is received from IRS in error for ozone-depleting chemicals tax paid pursuant to Notice 90-35. Notice 90-35, page 342, this Bulletin, advised taxpayers who are liable for other excise taxes that they could file the Form 720 for the first quarter and not report any liability for the taxes imposed by Internal Revenue Code Sections 4681 and 4682. However, the taxpayer should have deposited any amounts for these taxes on or before April 30, 1990, and April 1, 1990, respectively.

In cases where the taxpayer chose not to report the liability for taxes imposed by sections 4681 and 4682, but had properly made the deposits, IRS would not be able to determine that the deposits related to these new taxes. Without instructions to the contrary, these deposits would be treated as overpayments of tax and refunded.

If the taxpayer has received a refund in error, the refund check should be returned to IRS (uncashed) along with the explanation that the taxpayer is returning an erroneous refund of the taxes imposed by sections 4681 and 4682. The refund check and explanation must be returned to the service center where the Form 720 was filed. Taxpayers who return the check with the explanation will not be charged interest on that amount if the deposit was made timely. As explained in IRS Notice 90-35, the temporary regulations under sections 4681 and 4682 will provide instructions for reporting the taxpayer's additional liability for these taxes.

Taxpayers who have already cashed such erroneous refund checks may remit the full amount of the erroneous refund (including any interest allowed) with an explanation that the amount is a repayment of an erroneous refund of ozone-depleting chemicals tax to be reported on Form 720.

It is important for taxpayers to notify IRS of the erroneous refund as soon as the taxpayer receives the check. In cases where IRS notifies the taxpayer of an erroneous refund and there is a delay in returning the refund, interest may be charged.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 90-1

CONTENTS

PART I — PROCEDURES

SECTION 1. PURPOSES	p. 361		
SECTION 2. SCOPE	p. 361	.01	Associate Chief Counsel (Technical) provides rules
		.02	Items under the jurisdiction of Associate Chief Counsel (Technical)
		.03	Rulings relating to international transactions
		.04	Rulings relating to firearms, alcohol, and tobacco taxes
		.05	Rulings relating to employee plans and exempt organizations
SECTION 3. INSTRUCTIONS TO TAXPAYER	p. 361	.01	Office where request for ruling should be sent
		.02	Duplicate request for ruling
		.03	Penalties of perjury statement
		.04	User fees
		.05	Issuance of single ruling letter
		.06	Multiple issue ruling request
		.07	Complete statement of facts and other information required
		.08	True copies of contracts, wills, deeds, etc. must be submitted

.09 All material facts must be included

.10 Supporting statement—no rule areas where issues are clearly addressed by published authorities

.11 Statement required as to identical issue in prior return

.12 Notification of National Office if examination of issue begins

.13 "Two-part" ruling requests

1. Statements required with two-part ruling request
   (a) Complete statement of facts
   (b) Summary statement of facts to be controlling
2. Additional matters regarding the "two-part" procedure
   (a) "Two-part" procedure is elective
   (b) Taxpayer's rights and responsibilities
   (c) Service's rights
   (d) If "two-part" ruling request is inconsistent with other procedures

.14 Statement of relevant authorities in support of taxpayer's views

.15 Statement of deletions under section 6110 of the Code

.16 Requests to be signed by taxpayer or authorized representative who must have a power of attorney (Form 2848) and be

1. an attorney,
2. a certified public accountant,
3. a person enrolled to practice before the Service, or
4. a foreign representative who has received a "Letter of Authorization" from the Director of Practice, pursuant to section 10.7(b) of Treasury Department Circular No. 230.

.17 Copies of ruling letter

.18 Request for ruling that lacks essential information

.19 Additional information

.20 Request for conference

.21 Request for ruling processed in regular order; expeditious handling procedures

.22 Status request

.23 Section 6110 procedures regarding protest of disclosure of ruling letter

.24 Request for delay of public inspection

.25 Attach a copy of ruling letter to taxpayer's return

.26 Appeal procedures for adverse determination letters under section 521 of the Code

.27 Director of Practice will be informed of what are believed to be violations of Treasury Department Circular No. 230

SECTION 4. SPECIFIC GUIDELINES FOR REQUESTS UNDER CERTAIN CODE SECTIONS AND PERTAINING TO CERTAIN SUBJECT MATTERS p. 368

SECTION 5. HANDLING OF RULING REQUESTS p. 370

.01 21-calendar day contact

.02 Subject matters included in a 21-day procedure

1. Assistant Chief Counsel (Corporate)
2. Assistant Chief Counsel (Employee Benefits and Exempt Organizations)
3. Assistant Chief Counsel (Financial Institutions and Products)
4. Assistant Chief Counsel (Income Tax and Accounting)
5. Assistant Chief Counsel (Passthroughs and Special Industries)

.03 Procedures followed regarding ruling requests

1. 21-calendar day Branch contact
2. Multiple Branch jurisdiction
3. Modification of transaction
4. Informal opinions not binding
5. Ruling processed under present procedures

.04 Assistant Chief Counsel (Corporate) primary responsibility

.05 Assistant Chief Counsel (Employee Benefits and Exempt Organizations) primary responsibility

.06 Assistant Chief Counsel (Financial Institutions and Products) primary responsibility

.07 Assistant Chief Counsel (Income Tax and Accounting) primary responsibility

.08 Assistant Chief Counsel (Passthroughs and Special Industries) primary responsibility

SECTION 6. CONFERENCES IN THE NATIONAL OFFICE p. 372

.01 Conference only in connection with a ruling request; how it is scheduled

.02 One conference of right; who will attend from the Service

.03 Employment tax matters

.04 No tape or other verbatim recording

.05 Tentative recommendations

.06 Additional conferences

.07 Post-conference submissions

.08 Discretionary pre-submission conferences

SECTION 7. WITHDRAWAL OF REQUESTS p. 374

SECTION 8. EFFECT OF RULINGS p. 374

.01 Reliance, revocation or modification; section 7805(b) of the Code

.02 District Director's responsibility

.03 Contrary conclusion by field office

.04 Ways in which a ruling found to be in error is modified or revoked

.05 Circumstances in which revocation or modification of a ruling will not be applied retroactively

.06 Application of ruling restricted to transaction; except in rare or unusual circumstances, ruling not affected by regulations issued later

.07 Retroactivity; ruling on continuing or series of actions, illustrations

.08 Retroactivity; sale or lease subject to excise tax
.09 Retroactivity; completed transaction

SECTION 9. PROCEDURES FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF RULINGS p. 376
.01 Application of section 7805(b) of the Code
.02 Form of request to limit the retroactive effect of a modification or revocation of a ruling letter
.03 Taxpayer's right to conference

SECTION 10. DETERMINATION LETTERS ISSUED BY DISTRICT DIRECTOR p. 377
.01 In general
1. In income and gift tax matters
2. In estate tax matters
3. In generation-skipping transfer tax matters
4. In employment and excise tax matters
.02 Letters not issued by District Director
.03 Letters issued under section 1033 of the Code
.04 Requests concerning income, estate, or gift tax returns
.05 Office where request for determination letter should be sent
.06 Attach a copy of determination letter to taxpayer's return

SECTION 11. REVIEW OF DETERMINATION LETTERS p. 378

SECTION 12. EFFECT OF DETERMINATION LETTERS p. 378

SECTION 13. PROCEDURES FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF DETERMINATION LETTERS p. 378
.01 Form of request to limit the retroactive effect of a modification or revocation of a determination letter
.02 Taxpayer's right to a conference when technical advice is requested

SECTION 14. EFFECT OF INFORMATION LETTER p. 379

PART II—GENERAL

SECTION 15. GENERAL PRACTICE AND DEFINITIONS p. 379
.01 Issuance of rulings by National Office
.02 Issuance of determination letters by District Director
.03 Taxpayer
.04 Ruling

.05 Determination letter
.06 Information letter
.07 Revenue ruling
.08 Closing agreement

SECTION 16. ORAL ADVICE TO TAXPAYERS p. 380
.01 Discuss substantive and procedural tax issues
.02 Technical assistance from District Office or Service Center

SECTION 17. RULINGS ISSUED BY THE NATIONAL OFFICE p. 381
.01 In income and gift tax matters—when rulings will be issued on consummated transactions, section 1.9100-1 requests, and specific procedures for accounting period and method changes
.02 In estate tax matters
1. In general
2. In matters involving additional tax under section 2032A(c) of the Internal Revenue Code
.03 In generation-skipping transfer tax matters
.04 In employment and excise tax matters
.05 In administrative provisions matters
.06 Rulings to business associations or groups
.07 Rulings pending adoption of regulations
1. Answer is clear
2. Answer reasonably certain
3. Issues covered by Rev. Proc. 88-18

SECTION 18. DISCRETIONARY AUTHORITY TO ISSUE RULINGS AND DETERMINATION LETTERS p. 383
.01 General no rule areas
.02 Specific no rule areas where issues are clearly addressed by published authorities
.03 No ruling on alternative plans or hypothetical situations
.04 Ordinarily no ruling on only part of an integrated transaction
.05 Constructive sales price under section 4216(b) or 4218(c) of the Code

SECTION 19. DISTRICT OFFICE REFERRAL OF MATTERS TO THE NATIONAL OFFICE p. 384
.01 Request for determination letters
.02 No rule areas

SECTION 20. REFERRAL OF MATTERS TO DISTRICT OFFICES p. 384

SECTION 21. CHANGES p. 384

SECTION 22. EFFECT ON OTHER DOCUMENTS p. 385

PART I—PROCEDURES

SECTION 1. PURPOSE

The purpose of this revenue procedure is to update Rev. Proc. 89-1, 1989-1 C.B. 740, as amplified, modified, and supplemented, which provides procedures for issuing rulings, determination letters, and information letters, and for entering into closing agreements on specific issues involving the interpretation or application of the federal tax laws. It also tells taxpayers and their representatives where to send requests for rulings, determination letters, and information letters. It gives the steps to follow so that requests may be handled more efficiently. Changes to this revenue procedure will be incorporated annually in a new revenue procedure published as the first revenue procedure of the year.

SEC. 2. SCOPE

Associate Chief Counsel (Technical) provides rules

.01 The Chief Counsel through the Associate Chief Counsel (Technical) provides basic principles and rules for the uniform interpretation and application of the federal tax laws under the jurisdiction of the Associate Chief Counsel (Technical).

Items under the jurisdiction of the Associate Chief Counsel (Technical)

.02 This revenue procedure applies only to ruling requests, information letters, and closing agreements under the jurisdiction of the Associate Chief Counsel (Technical) and to requests for determination letters under the jurisdiction of field offices that relate to Code sections under the jurisdiction of the Associate Chief Counsel (Technical).

Rulings relating to international transactions

.03 The procedures for obtaining rulings, closing agreements, and information letters on specific tax issues involving the interpretation or application of the federal tax laws and income tax treaties relating to international transactions are contained in Rev. Proc. 87-4, 1987-1 C.B. 529, as modified by Rev. Proc. 88-4, 1988-1 C.B. 586. See also Rev. Proc. 89-4, 1989-1 C.B. 767 (user fees).

Rulings relating to firearms, alcohol, and tobacco taxes

.04 The procedures for obtaining rulings, etc., that apply specifically to federal firearms, alcohol, and tobacco taxes under subtitle E of the Internal Revenue Code are under the jurisdiction of the Bureau of Alcohol, Tobacco and Firearms.

Rulings relating to employee plans and exempt organizations

.05 The procedures for obtaining rulings, determination letters, etc., on employee plans and exempt organizations are under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations). See Rev. Proc. 83-36, 1983-1 C.B. 763, as modified by Rev. Proc. 87-40, 1987-2 C.B. 514. See also Rev. Proc. 89-4 (user fees). However, the jurisdiction of the Associate Chief Counsel (Technical) includes section 521 of the Code, on exemption of farmers' cooperatives from tax; section 526, on shipowners' protection and indemnity associations; and section 528, on certain homeowners associations.

SEC. 3. INSTRUCTIONS TO TAXPAYER

Office where request for ruling should be sent

.01 A request for a ruling letter by the National Office should be sent to the Internal Revenue Service, Associate Chief Counsel (Technical), Attention CC:CORP:T, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Requests may be hand delivered to room 6561, 1111 Constitution Avenue, N.W., Washington, DC 20224, between 8:30 a.m. and 4:00 p.m. on working days.

Duplicate request for ruling

.02 The taxpayer should submit a request for a ruling or a determination letter in duplicate if (1) more than one issue is presented in the request, or (2) a closing agreement is requested on the issue presented. It is not necessary to submit requests in duplicate under other circumstances, except as set forth in section 3.15.

Penalties of perjury statement

.03 A request for a ruling or determination letter and any factual information or change in the ruling request submitted at a later time must be accompanied by a declaration in the following form: "**Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the requested ruling or determination letter are true, correct, and complete.**" The declaration may not be made by the taxpayer's representative. It must be signed by the person or persons on whose behalf the request is made. The person who signs for a corporate taxpayer must be an officer of the corporate taxpayer who has personal knowledge of the facts. The officer must be one whose duties are not limited to obtaining a ruling or determination letter from the Service. Furthermore, if the corporate taxpayer is a member of an affiliated group filing consolidated returns, a penalties-of-perjury statement must also be submitted by the common parent of the group. The person signing for a trust or partnership must be a trustee or general partner who has personal knowledge of the facts. If multiple submissions of additional factual information are made, one declaration that refers specifically to each of the additional submissions may be provided.

User fees

.04 Section 10511 of the Revenue Act of 1987, Pub. L. 100-203, enacted December 22, 1987, requires the payment of user fees for requests for rulings, opinion letters, determination letters, and similar requests. Rev. Proc. 89-4, 1989-1 C.B. 767, which was modified by Rev. Proc. 89-9, 1989-1 C.B. 780, and Rev. Proc. 89-13, 1989-1 C.B. 801, contains the schedule of fees and provides guidance for administering the user fee requirements. The user fee payable with respect to each category of submission under the jurisdiction of the Associate Chief Counsel (Technical) is as follows:

Application with respect to accounting periods (Forms 1128 and 2553)	$150
Change in accounting method (Form 3115)	$200
All other rulings (which includes accounting period, accounting method, and earnings and profits requests other than those submitted on Forms 1128, 2553, 3115, and 5452)	$300

Issuance of single ruling letter

.05 If more than one issue is presented in a request for a ruling, the Service generally will issue a single ruling letter. However, the taxpayer may request a separate ruling letter on any of the issues. Unless the Service determines that it is not feasible or not in the best interest of the Service to comply with such a request, it will issue separate ruling letters.

Multiple issue ruling request

.06 When multiple issues are involved in a single factual situation and separate letters requesting rulings are submitted, a statement to this effect must be included in each ruling letter request. The Service in issuing each ruling will state that separate rulings have been issued or requests for rulings are pending.

Complete statement of facts and other information required

.07 Each request for a ruling or a determination letter must contain a complete statement of all of the facts relating to the transaction. Such facts include: names, addresses, telephone numbers, and taxpayer identification numbers of all interested parties; the location of the District Office that has or will have examination jurisdiction over the return (not the Service Center where the return is filed); and a full and precise statement of the business reasons for the transaction and a carefully detailed description of the transaction. (The term "all interested parties" does not mean that a list is required of all shareholders of a widely-held corporation requesting a ruling relating to a reorganization, or a list of employees where a large number may be involved.) If the request deals with only one step of a larger

integrated transaction, the facts, circumstances, etc. relating to the entire transaction must be submitted. However, see section 18.04 of this revenue procedure (Rev. Proc. 90-1).

True copies of contracts, wills, deeds, etc. must be submitted

.08 True copies of all contracts, wills, deeds, agreements, instruments, and other documents in the transaction must be submitted with the request. Original documents, such as contracts, wills, etc., should not be submitted because they become part of the Service's file and will not be returned. If the request concerns a corporate distribution, reorganization, or similar transaction, the corporate balance sheet and profit and loss statement should be submitted. If the request relates to a prospective transaction, the most recent balance sheet and profit and loss statement should be submitted.

All material facts must be included

.09 All material facts in documents must be included in the taxpayer's letter requesting a ruling or in supplemental letters, and not merely incorporated by reference, and must be accompanied by an analysis of their bearing on the issue or issues, specifying the provisions that apply.

Supporting statement—no rule areas where issues clearly addressed

.10 With respect to a ruling request postmarked or, if not mailed, received on or after February 5, 1990, the request for a ruling must contain a statement supporting the taxpayer's judgment that the issue in the ruling request is not clearly and adequately addressed by a statute, regulation, decision of the Supreme Court, tax treaty, revenue ruling, revenue procedure, notice, or other authority published in the Internal Revenue Bulletin. See section 18.02.

Statement required as to identical issue in prior return

.11 The request must contain a statement of whether, to the best of the knowledge of the taxpayer and the taxpayer's representative(s), if any, the identical issue is in a prior return of the taxpayer (or in a return for any year of a related taxpayer within the meaning of section 267 of the Code, or of a member of an affiliated group of which the taxpayer is also a member within the meaning of section 1504). If so, the statement must specify whether the issue (1) is being examined by a District Director, (2) has been examined and the statutory period of limitation on either assessment or for filing a claim for refund or credit of tax has not expired, or a closing agreement covering the issue or liability has not been entered into by a District Director, (3) is being considered by an Appeals Office in connection with the taxpayer's return for an earlier period, or has been considered by an Appeals Office and the statutory period of limitation on either assessment or for filing a claim for refund or credit of tax has not expired, or a closing agreement covering the issue or liability has not been entered into by an Appeals Office, or (4) is pending in litigation in a case involving the taxpayer or a related taxpayer. The request must also contain a statement whether, to the best of the knowledge of the taxpayer and the taxpayer's representative, if any, the identical or similar issue has been (i) submitted to the Service, by the taxpayer or its predecessor, but withdrawn before a ruling was issued, or (ii) ruled on by the Service to the taxpayer or to the taxpayer's predecessor. If so, the statement must specify the date of submission, withdrawal, or ruling and other details of the Service's consideration of the issue.

Notification of National Office if examination of issue begins

.12 If, after the request is filed but before a ruling is issued, the taxpayer knows that an examination of the issue by a District Director has been started, the taxpayer must notify the National Office of such action. If a return is filed before a ruling is received from the National Office concerning the issue, a copy of the request must be attached to the return. This alerts the District Office and avoids premature District action on the issue.

"Two part" ruling requests

.13 As an alternative procedure (known as the "two-part" ruling request procedure) for the issuance of rulings on prospective transactions, the taxpayer may submit a summary of the facts considered to be controlling the issue, in addition to the complete statement required for ruling requests by section 3.07. If the National Office agrees with the summary, the National Office will use it as the basis for the ruling.

Statements required with "two-part" ruling request

1. To use this procedure, the taxpayer should submit the following with the request for a ruling:

Complete statement of facts

(a) A complete statement of facts about the transaction, together with related documents, as required by sections 3.07 and 3.08, and

Summary statement of facts to be controlling

(b) A summary statement of the facts believed to be controlling in reaching the requested conclusion. When the taxpayer's statement of controlling facts is accepted, the Service will base its ruling on these facts and only this statement ordinarily will be incorporated in the ruling letter.

Additional matters regarding the "two-part" procedure

2. It is emphasized that the following applies to the "two-part" procedure:

"Two-part" procedure is elective

(a) The taxpayer may elect this procedure for a "two-part" ruling request. It is not to be considered a required substitute for the regular procedures provided by this revenue procedure;

Taxpayer's rights and responsibilities

(b) The taxpayer's rights and responsibilities are the same under the "two-part" ruling request procedures as those provided in this revenue procedure;

Service's rights

(c) The Service reserves the right to rule on the basis of a more complete statement of facts it considers controlling and to seek more information in developing facts and restating them; and

If "two-part" ruling request is inconsistent with other procedures

(d) The "two-part" ruling request procedure will not apply if it is inconsistent with other procedures, such as those dealing with requests for permission to change accounting methods or periods; applications for recognition of exempt status under section 521 of the Code; or rulings on employment tax status.

Statement of relevant authorities in support of taxpayer's views

.14 If the taxpayer advocates a particular conclusion, an explanation of the grounds for the assertion must be furnished, together with a statement of relevant authorities in support of the taxpayer's views. Even though the taxpayer is urging no particular tax treatment of a proposed or prospective transaction, the taxpayer's views on the tax results of the proposed action and a statement of relevant authorities to support those views must be furnished. In addition, the taxpayer is encouraged to inform the Service, and discuss the implications of any legislation, tax treaties, court decisions, regulations, revenue rulings, or revenue procedures that the taxpayer determines to be contrary to the position advanced. If the taxpayer determines that there are no contrary authorities, a statement in the ruling request to this effect would be helpful.

Identification and discussion of contrary authorities will generally enable Service personnel to arrive more quickly at a full understanding of the issue and relevant authorities. There is a further advantage to the taxpayer. When Service personnel receive the request, they will have before them the taxpayer's thinking on the effect and applicability of contrary authorities. Such information should, therefore, make research easier and lead to earlier action by the Service. Conversely, failure to disclose and distinguish significant contrary authorities may result in requests for additional memoranda that will delay action on the ruling request.

Statement of deletions under section 6110 of the Code

.15 To assist the Service in making the deletions required by section 6110(c) of the Code from the text of rulings and determination letters to be made open to public inspection under section 6110(a), a deletions statement must accompany each request. The statement must either state that no information other than names, addresses, and identifying numbers need be deleted or, if more information is proposed to be deleted, the statement must indicate the deletions proposed by the person requesting the ruling or determination letter. If the latter alternative is

chosen, the statement must be made in a separate document, and it must be accompanied by a copy of the request for a ruling or determination letter and supporting documents, on which must be shown, by the use of brackets, the material that the person making the request believes should be deleted pursuant to section 6110(c). The statement of proposed deletions must indicate the statutory basis, under section 6110(c), for each proposed deletion. The statement of proposed deletions must not appear or be referred to anywhere in the request for a ruling or determination letter. If the person making the request decides to ask for additional deletions before the ruling or determination letter is issued, additional statements may be submitted. The procedures in this paragraph also apply to additional information that is submitted after the initial request.

Requests to be signed by taxpayer or authorized representative who must have a power of attorney (Form 2848) and be:

.16 A request by or for a taxpayer must be signed by the taxpayer or the taxpayer's authorized representative. If the request is signed by a representative, or if the representative is to appear before the Service in connection with the request, the representative must be:

an attorney,

1. an attorney who is a member in good standing of the bar of the highest court of any state, possession, territory, commonwealth, or the District of Columbia, and who files with the Service a written declaration that he or she is currently qualified as an attorney and is authorized to represent the taxpayer;

a certified public accountant,

2. a certified public accountant who is qualified to practice in any state, possession, territory, commonwealth, or the District of Columbia, and who files with the Service a written declaration that he or she is currently qualified as a certified public accountant and is authorized to represent the taxpayer;

a person enrolled to practice before the Service, or

3. a person, other than an attorney or certified public accountant who is currently enrolled to practice before the Service, and who files with the Service a written declaration that he or she is currently enrolled (including in the declaration either the enrollment number or the expiration date of the enrollment card) and is authorized to represent the taxpayer. (See Treasury Department Circular No. 230 (31 CFR Part 10), 1983-2 C.B. 742, for the rules on who may practice before the Service); or

a foreign representative who has received a "Letter of Authorization" from the Director of Practice, pursuant to section 10.7(b) of Treasury Department Circular No. 230.

4. a foreign representative who has received a "Letter of Authorization" from the Director of Practice, pursuant to section 10.7(b) of Treasury Department Circular No. 230. Practitioners may make a written request for a "Letter of Authorization" to: Office of Director of Practice, PM:HR:DP, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, DC 20224. Section 10.7(b) of Circular No. 230 authorizes the Commissioner to allow any person to represent another without enrollment for the purpose of a particular matter. Without a "Letter of Authorization," the foreign representative may not represent the taxpayer before the Service.

The requirements above do not apply to an individual representing his or her fulltime employer, or to a bona fide officer, administrator, administratrix, trustee, etc., representing a corporation, trust, estate, association, or organized group. An unenrolled preparer of a return (other than an attorney or certified public accountant referred to in (1) and (2) above) who is not a full-time employee or a bona fide officer, administrator, administratrix, trustee, etc., may not represent a taxpayer in connection with a ruling or a determination letter.

Any authorized representative, whether or not enrolled to practice, must also comply with the conference and practice requirements of the Statement of Procedural Rules (26 CFR 601). Form 2848, Power of Attorney, and Form 2828-D, Authorization and Declaration, may be used with regard to rulings, closing agreements, and determination letters requested under this revenue procedure.

Copies of ruling letter

.17 If a taxpayer has more than one representative, the taxpayer should designate which representatives are to receive a copy of the ruling. Copies of rulings will be sent to no more than two representatives, provided that they are located at different mailing addresses. If a taxpayer does not designate which representative is to receive a copy of the ruling, a copy of the ruling will be sent to the first representative named on the latest power of attorney. If the original of the ruling is to be sent to a representative, the power of attorney should contain a statement to that effect and designate the mailing address of the representative.

Request for ruling that lacks essential information

.18 If a request for a ruling or determination letter does not comply with all the provisions of this revenue procedure, a representative of the Branch will indicate during the initial contact with the taxpayer the requirements that have not been met. If the request for a ruling lacks essential information, which may include additional information needed to satisfy the procedural requirements of this revenue procedure as well as substantive changes to transactions or documents needed from the taxpayer, the taxpayer will be told that if the information is not received within 30 calendar days, the request will be closed. If the information is received after the request is closed, it will be reopened and treated as a new request as of the date the essential information is received. In the processing of such a request, another user fee will be required before the case can be reopened. A request for a ruling letter sent to the District Director that does not comply with the provisions of this revenue procedure will be returned by the District Director for corrections before it is sent directly to the National Office.

Additional Information

.19 Material facts furnished to the Service by telephone or orally at a conference must be promptly confirmed by letter to the Service with a declaration in the form described in section 3.03. This confirmation and any additional information requested by the Service that is not part of the information requested during the inital contact described in section 3.18 must be furnished within 21 calendar days to be considered part of the request. An extension of the 21-day period will be granted only if justified in writing by the taxpayer and approved by the Branch Chief, Senior Technician Reviewer, or Assistant to the Branch Chief (or Assistant Branch Chief) of the Branch to which the case is assigned. A request for extension should be submitted before the end of the 21-day period. If unusual circumstances close to the end of the 21-day period make a written request impractical, within the 21-day period the National Office should be told of the problem and that the written request for extension will be coming soon. Such a request must be sent promptly. The taxpayer or taxpayer's representative will be told promptly and later in writing of the approval or denial of the requested extension.

There is no right of appeal to a denial of an extension request. Because the purpose of these procedures is to speed up the ruling process, the taxpayer is encouraged to submit the required relevant material promptly. Therefore, requests for extension should be justified by compelling facts and circumstances. If the Service is not made aware, as provided above, of problems in meeting the 21-day period, or if the request is not sent promptly after the National Office is notified of problems in meeting the 21-day period, the Service will process the case on the assumption that no further submission will be received.

Request for conference

.20 A taxpayer who wants to have a conference on the issue or issues involved should indicate this in writing when, or soon after, filing the request. See also section 6 (Conferences in the National Office) and section 9 (Procedures for Requesting Application of Section 7805(b)) of this revenue procedure.

Request for ruling processed in regular order, expeditious handling procedures

.21 The Service processes requests for ruling and determination letters in order of date received, and as expeditiously as possible. Consideration of a request for processing ahead of its regular order, or by a specified time, delays the processing of other matters. Requests for processing ahead of the regular order must be made in writing, preferably in a separate letter with, or soon after, the request. If the request is not made in a separate letter, then the letter in which the request is made should say, at the top of the first page: "**Expeditious Handling Is Requested. See**

page ____ of this letter." The request should give a compelling need for such treatment.

The Service cannot give assurance that any letter will be processed by the time requested. For example, the scheduling of a closing date for a transaction or a meeting of the board of directors or shareholders of a corporation, without regard for the time it may take to obtain a ruling or determination letter, will not be considered sufficient reason for handling a request ahead of its regular order. Nor will the possible effect of fluctuation in the market price of stocks on a transaction be considered sufficient reason for handling a request out of order. Requests by telegram will be treated in the same manner as requests by letter. Ruling and determination letters ordinarily are not issued by telegram. A request for expeditious handling will not cause the Communications and Records Unit to route the case to the Ruling Branch ahead of normal processing; and a request for expeditious handling will not be considered until the underlying ruling request has been found to satisfy the section 6110 requirements.

Status request

.22 A taxpayer may obtain information regarding the status of a request by calling the person whose name and telephone number is shown on the acknowledgement of receipt of the request or the person who contacts the taxpayer pursuant to the 21-calendar-day procedure. See section 5.01.

Section 6110 procedures regarding protest of disclosure of ruling letter

.23 After receiving the notice under section 6110(f)(1) of the Code of intention to disclose the ruling or determination letter (including a copy of the version proposed to be open to public inspection and notation of third-party communications under section 6110(d)), the person requesting the ruling or determination letter may protest the disclosure of certain information in the ruling or determination letter. That person must, within 20 calendar days, send a written statement to the Internal Revenue Service office indicated on the notice of intention to disclose identifying those deletions that the Service has not made and that the person requesting the ruling or determination letter believes should have been made. That person must also submit a copy of the version of the ruling or determination letter proposed to be open to public inspection on which the person indicates, by use of brackets, the deletions proposed by the taxpayer that have not been made by the Service. Generally, the Service will not consider the deletion under this subparagraph of any material that the taxpayer did not propose to be deleted before the ruling or determination letter was issued.

Within 20 days after it receives the response to the notice under section 6110(f)(1) of the Code, the Service will mail to that person its final administrative conclusion regarding the deletions to be made. The taxpayer does not have the right to a conference to resolve any disagreements concerning material to be deleted from the text of the ruling. However, these matters may be taken up at any conference that is otherwise scheduled regarding the request.

Request for delay of public inspection

.24 After receiving the notice under section 6110(f)(1) of Code of intention to disclose (but not later than 60 calendar days after the notice is mailed), the person requesting a ruling or determination letter may send a request for delay of public inspection under either section 6110(g)(3) or (4). The request for delay must be sent to the Internal Revenue Service office indicated on the notice of intention to disclose. A request for delay under section 6110(g)(3) must contain the date on which it is expected that the underlying transaction will be completed. The request for delay under section 6110(g)(4) must contain a statement from which the Commissioner may determine that there are good reasons for the delay.

Attach a copy of ruling letter to taxpayer's return

.25 A taxpayer who receives a ruling before filing a return about any transaction that has been consummated and that is relevant to the return being filed should attach a copy of the ruling to the return when it is filed.

Appeal procedures for adverse determination letters under section 521 of the Code

.26 For appeal procedures with regard to adverse determination letters under section 521 of the Code and revocation or modification of exemption rulings and determination letters under section 521, see Rev. Proc. 84-46, 1984-1 C.B. 541, as and modified by Rev. Proc. 85-32, 1985-2 C.B. 414.

Director of Practice will be informed of what are believed to be violations of Treasury Department Circular No. 230

.27 In those situations when the National Office believes that the taxpayer's representative is not in compliance with Treasury Department Circular No. 230, the National Office will bring the matter to the attention of the Director of Practice.

SEC. 4. SPECIFIC GUIDELINES FOR REQUESTS UNDER CERTAIN CODE SECTIONS AND PERTAINING TO CERTAIN SUBJECT MATTERS

CODE SECTION	REVENUE PROCEDURE
103, 141-150, 7478 Issuance of state or local obligations	Rev. Proc. 88-32, 1988-1 C.B. 833 (for issuers), Rev. Proc. 88-33, 1988-1 C.B. 835 (for nonissuing parties and for outstanding obligations), Rev. Proc. 88-31, 1988-1 C.B. 832 (for approval of areas of chronic economic distress), and Rev. Proc. 82-26, 1982-1 C.B. 476 (for "on behalf of" and similar issuers)
162(i) (former 162(k))	Rev. Proc. 87-28, 1987-1 C.B. 770
302, 311 Checklist Questionnaire	Rev. Proc. 86-18, 1986-1 C.B. 551, and Rev. Proc. 77-41, 1977-2 C.B. 574
302(b)(4) Checklist Questionnaire	Rev. Proc. 81-42, 1981-2 C.B. 611
331, former 337 Checklist Questionnaire	Rev. Proc. 86-16, 1986-1 C.B. 546
332, 334(b)(1), 334(b)(2) Checklist Questionnaire	Rev. Proc. 81-68, 1981-2 C.B. 723
351 Checklist Questionnaire	Rev. Proc. 83-59, 1983-2 C.B. 575
355 Checklist Questionnaire	Rev. Proc. 86-41, 1986-2 C.B. 716, as amplified by Rev. Proc. 89-28, 1989-1 C.B. 893. See, however, Rev. Proc. 89-39, 1989-1 C.B. 922, which describes certain circumstances, relating to the corporate business requirements of section 1.355-2(b) of the regulations, where the Service will not issue advance rulings.
368(a)(1)(E) Checklist Questionnaire	Rev. Proc. 81-60, 1981-2 C.B. 680. See, however, section 3.0123 of Rev. Proc. 90-3, page 402, this Bulletin, which describes circumstances under which the Service will not issue advance rulings or determination letters as to whether a transaction constitutes a corporate recapitalization within the meaning of section 368(a)(1)(E) (or a transaction that also qualifies under section 1036)

368 Corporate; general	Rev. Proc. 77-37, 1977-2 C.B. 568, as superseded in part by Rev. Proc. 79-14, 1979-1 C.B. 496, and as amplified by Rev. Proc. 77-41, 1977-2 C.B. 574, Rev. Proc. 83-81, 1983-2 C.B. 598, Rev. Proc. 84-42, 1984-1 C.B. 521, (see also, Rev. Proc. 90-3, this Bulletin), and Rev. Proc. 86-42, 1986-2 C.B. 722; Rev. Proc. 87-22, 1987-1 C.B. 718; and Rev. Proc. 89-50, 1989-2 C.B. 631.
521 Appeal procedure with regard to adverse determination letters and revocation or modification of exemption rulings and determination letters	Rev. Proc. 84-46, 1984-1 C.B. 541, as modified by Rev. Proc. 85-32, 1985-2 C.B. 414
1.9100-1; granting extensions for making elections	Rev. Proc. 79-63, 1979-2 C.B. 578; and Rev. Proc. 84-74, 1984-2 C.B. 736. See also, section 3.11 of Rev. Proc. 90-2, page 386, this Bulletin.
SUBJECT MATTERS	**REVENUE PROCEDURE**
Accounting methods	Rev. Proc. 84-74, 1984-2 C.B. 736, as modified by Rev. Proc. 88-15, 1988-1 C.B. 683; also Rev. Proc. 90-1 (this revenue procedure) for which sections 3.01, 3.03, 3.04, 3.07, 3.14, 3.16, 3.17, 3.19, 3.20, 3.21, 3.22, 3.27, 5.06, 5.07, 5.08, 6, 7, 8, 16, and 18.03 are applicable
Accounting periods; adopt, retain or change for partnership, S corporation and personal service corporation	Rev. Proc. 87-32, 1987-2 C.B. 396
Accounting periods; changes in period	Rev. Proc. 84-34, 1984-1 C.B. 508; also Rev. Proc. 90-1 (this revenue procedure) for which sections 3.01, 3.03, 3.04, 3.07, 3.14, 3.16, 3.17, 3.18, 3.19, 3.20, 3.21, 3.22, 3.27, 5.07, 6, 7, 8, 16, and 18.03 are applicable
Advance rulings on estate tax matters	Rev. Proc. 88-50, 1988-2 C.B. 711, as incorporated into Rev. Proc. 90-1 (this revenue procedure), section 17.02
Classification of an organization as a partnership	Rev. Proc. 89-12, 1989-1 C.B. 798; and Rev. Proc. 86-12, 1986-1 C.B. 534
Classification of liquidating trusts	Rev. Proc. 82-58, 1982-2 C.B. 847
Earnings and profits determinations	Rev. Proc. 75-17, 1975-1 C.B. 677; also Rev. Proc. 90-1 (this revenue procedure) for which sections 3.01, 3.03, 3.07, 3.16, 3.17, 3.19, 3.20, 3.21, 3.22, 3.27, 5.07, 6, and 16 are applicable
Deferred intercompany transactions; election not to defer gain or loss	Rev. Proc. 82-36, 1982-1 C.B. 490
Leveraged leasing	Rev. Proc. 75-21, 1975-1 C.B. 715, and Rev. Proc. 75-28, 1975-1 C.B. 752
Rate orders; regulatory agency; normalization	A ruling request that involves a question of whether a rate order, proposed or issued by a regulatory agency, will meet the normalization requirements of sections 46(f), 167(1), and 168(f)(2) (pre-Tax Reform Act of 1986, section 163(e)(3)) of the Code ordinarily will not be considered unless the taxpayer states in the request for ruling whether:

(1) the regulatory authority responsible for establishing or approving the taxpayer's rates has reviewed the request and believes that the request is adequate and complete, and

(2) the taxpayer will permit the regulatory authority to participate in any National Office conference concerning the request. If the taxpayer or the regulatory authority informs a consumer advocate of the request for a ruling and the advocate wishes to communicate with the Service regarding the request, any such communication should be sent to Internal Revenue Service, Associate Chief Counsel (Technical), Attention CC:P&SI:6, Room 5112, 1111 Constitution Avenue, N.W., Washington, DC 20224. These communications will be treated as third party contacts for purposes of section 6110 of the Code.

Unfunded deferred compensation — Rev. Proc. 71-19, 1971-1 C.B. 698

SEC. 5. HANDLING OF RULING REQUESTS

21-calendar day contact

.01 Within 21 calendar days after a ruling request is received in the Branch, Service personnel will contact the taxpayers to discuss informally the procedural and substantive issues in the ruling request. See section 5.03 for procedures.

Subject matters included in the 21-day procedure

.02 The following subject matters are included in the 21-calendar day procedure:

Assistant Chief Counsel (Corporate)

1. All matters within the jurisdiction of the Assistant Chief Counsel (Corporate).

Assistant Chief Counsel (Employee Benefits and Exempt Organizations)

2. All matters within the jurisdiction of the Assistant Chief Counsel (Employee Benefits and Exempt Organizations) involving

(a) Stock options,

(b) Employment and self-employment taxes (except ruling requests from individuals for employment status submitted on Forms SS-8), and

(c) Rental value of parsonages.

Assistant Chief Counsel (Financial Institutions and Products)

3. All matters within the jurisdiction of the Assistant Chief Counsel (Financial Institutions and Products) except cases concerning insurance issues requiring actuarial computations.

Assistant Chief Counsel (Income Tax and Accounting)

4. All matters within the jurisdiction of the Assistant Chief Counsel (Income Tax and Accounting), except cases involving a request for change in accounting methods or periods.

Assistant Chief Counsel (Passthroughs and Special Industries)

5. All matters within the jurisdiction of the Assistant Chief Counsel (Passthroughs and Special Industries).

Procedures followed regarding ruling requests

.03 Procedures to be followed regarding ruling requests are:

21-calendar day Branch contact

1. Within 21 calendar days after a ruling request has been received in the Branch having jurisdiction, a representative of the Branch will contact the taxpayer to discuss the procedural issues in the ruling requests covered by this procedure. Considering the complexity of some cases or the number of issues involved, it may not be possible for the Branch representative to discuss the substantive issues in the ruling request during this initial contact. However, when possible, as to each issue coming within the jurisdiction of the Branch, the Branch representative will tell the taxpayer:

(a) whether the Branch representative will recommend that the Service rule as the taxpayer requested, rule adversely on the matter, or not rule;

(b) whether the taxpayer should submit additional information or representations to enable the Service to rule on the matter; or

(c) whether because of the nature of the transaction, or the issue presented, a tentative conclusion on the issue cannot be reached.

Multiple Branch jurisdiction

2. When the rulings requested involve matters within the jurisdiction of more than one Branch, a representative of the Branch that received the original ruling request will tell the taxpayer within the initial 21-calendar-day contact period: (1) that the rulings requested involving matters within the jurisdiction of another Branch have been referred to the other Branch for consideration, and (2) that a representative of the other Branch will contact the taxpayer within 21 calendar days after receiving the referral to informally discuss the procedural and, to the extent possible, the substantive issues if covered by this procedure.

Modification of transaction

3. If something less than a fully favorable ruling is indicated, the Branch representative will tell the taxpayer if minor modifications of the transaction or adherence to certain published positions will warrant the issuance of a favorable ruling. In addition, the Branch representative may tell the taxpayer what representations must be furnished in a document to comply with the requirements of the Service. However, the Branch representative will not suggest precise changes that would materially alter the form of the proposed transaction. If, at the conclusion of the discussion, the Branch representative determines that a meeting in the National Office would better serve the purpose of developing or exchanging information, a meeting will be offered and an early meeting date arranged. This meeting will not be the taxpayer's conference of right, as described in this revenue procedure.

Informal opinions not binding

4. The Service will not be bound by the informal opinion expressed by the Branch representative or any other authorized Service representative under this procedure, and such an opinion cannot be relied upon as a basis for obtaining retroactive relief under the provisions of section 7805(b) of the Code.

Ruling processed under present procedures

5. The ruling request will then be processed under present procedures.

Assistant Chief Counsel (Corporate) primary responsibility

.04 The Assistant Chief Counsel (Corporate) has primary responsibility for providing basic principles and rules for uniform interpretation and application of the federal tax laws in those areas involving distributions in connection with corporate organizations, reorganizations, and liquidations; consolidated returns; allocation of income and deductions among taxpayers; acquisitions made to evade or avoid income tax; and, income taxes and earnings and profits of corporate taxpayers.

Assistant Chief Counsel (Employee Benefits and Exempt Organizations) primary responsibility

.05 The Assistant Chief Counsel (Employee Benefits and Exempt Organizations) has primary responsibility for providing basic principles and rules for uniform interpretation and application of the federal tax laws in those areas involving: income tax and other tax aspects of executive compensation and employee benefit programs (other than those within the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations)); and employment taxes and taxes on self-employment income.

Assistant Chief Counsel (Financial Institutions and Products) primary responsibility

.06 The Assistant Chief Counsel (Financial Institutions and Products) has primary responsibility for providing basic principles and rules for the uniform interpretation and application of the federal income tax laws in those areas involving: banks, savings and loan associations, real estate investment trusts (REITs), regulated investment companies (RICs), real estate mortgage investment conduits (REMICs), tax exempt obligations, insurance companies and products, and financial products.

Assistant Chief Counsel (Income Tax and Accounting) primary responsibility

.07 The Assistant Chief Counsel (Income Tax and Accounting) has primary responsibility for providing basic principles and rules for uniform application of the federal income tax laws in those areas involving: recognition and timing of income and deductions of individuals and corporations, sales and exchanges, capital gains and losses, various administrative provisions, accounting methods and periods, installment sales, equipment leasing, inventories, and the alternative minimum tax.

Assistant Chief Counsel (Passthroughs and Special Industries) primary responsibility

.08 The Assistant Chief Counsel (Passthroughs and Special Industries) has primary responsibility for providing basic principles and rules for uniform interpretation and application of the federal income tax laws in those areas involving income taxes of S corporations (except accounting periods and methods) and certain noncorporate taxpayers (including partnerships and trusts); estate, gift, generation-skipping transfer, and certain excise taxes; depreciation, depletion, and other engineering issues; cooperative housing corporations; farmers' cooperatives (under section 521 of the Code); the low-income housing credit; research and experimental expenditures; shipowners'protection and indemnity associations (under section 526); and certain homeowners associations (under section 528).

SEC. 6. CONFERENCES IN THE NATIONAL OFFICE

Conference only in connection with a ruling request: how it is scheduled

.01 A taxpayer may request a conference only in connection with a ruling request. Normally, a conference is scheduled only when the National Office considers it to be helpful in deciding the case or when an adverse decision is indicated. If conferences are being arranged for more than one request for a ruling involving the same taxpayer, they will be scheduled so as to cause the least inconvenience to the taxpayer. As stated in section 3.20, a taxpayer who wants to have a conference on the issue or issues involved should indicate this in writing when, or soon after, filing the request. If a conference has been requested, the taxpayer will be notified by telephone, if possible, of the time and place of the conference. The conference must be held within 21 calendar days after such contact has been made. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those stated in section 3.19.

One conference of right; who will attend from the Service

.02 A taxpayer is entitled, as a matter of right, to only one conference in the National Office unless one of the circumstances discussed in section 6.06 develops. This conference normally will be held at the Branch level and will be attended by a person who, at the time of the conference, has authority to sign the ruling letter in his or her own name or for the Branch Chief in the case being discussed.

When more than one Branch has taken an adverse position on an issue within its jurisdiction presented in a ruling request, or when the position ultimately adopted by one Branch will affect another Branch's determination, a representative from each Branch with the authority to sign in his or her own name or for the Branch

Chief will attend the conference. If more than one subject is to be discussed at the conference, the discussion will constitute a conference on each subject.

In order to promote a free and open discussion of the issues, the conference usually will be held after the Branch has had an opportunity to study the case. However, at the request of the taxpayer or representative, the conference of right may be held at an earlier stage in the consideration of the case than the Service ordinarily would designate. No taxpayer has a "right" to appeal the action of a Branch to an Assistant Chief Counsel or to any other official of the Service.

Employment tax matters

.03 In employment tax matters, only the party entitled to the ruling is entitled to a conference.

No tape or other verbatim recording

.04 Since conference procedures are informal, no tape, stenographic, or other verbatim recording of a conference will be made.

Tentative recommendations

.05 The senior Service representative present at the conference insures that the taxpayer has full opportunity to present views on all the issues that are in question. The Service representative explains the Service's tentative decision on the substantive issues and the reason for that decision. If the taxpayer advances prospective application under section 7805(b) of the Code, the Service representative will discuss the tentative recommendation concerning the request for relief and the reason for the tentative recommendation. No commitment will be made as to the conclusion that the Service will finally adopt.

Additional conferences

.06 An invitation to an additional conference will be extended if, after the conference of right, an adverse holding is proposed but on a new issue or on the same issue but on different grounds from those discussed at the first conference. There is no right to another conference when a proposed holding is reversed at a higher level with a result less favorable to the taxpayer if the grounds or arguments on which the reversal is based were discussed at the conference of right. The provision of this revenue procedure limiting the number of conferences to which a taxpayer is entitled will not prevent a taxpayer from attending further conferences when, in the opinion of National Office personnel, such conferences are necessary. All additional conferences of the type discussed in this paragraph are held only at the invitation of the Service.

Post-conference submissions

.07 It is the responsibility of the taxpayer to furnish in writing to the National Office any additional data, lines of reasoning, precedents, etc., that are proposed by the taxpayer and discussed at the conference but that were not previously or adequately presented in writing. The taxpayer must furnish the additional information within 21 calendar days. If the additional information is not received within that time, a ruling will be issued on the basis of the information on hand or, if appropriate, no ruling will be issued. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or taxpayer's representative of the Service's decision are the same as those stated in section 3.19.

Discretionary pre-submission conferences

.08 In certain instances, it will be advantageous to both the Service and the taxpayer to hold a conference prior to submission of a ruling request to discuss substantive or procedural issues relating to a proposed transaction. Where the taxpayer intends to file a ruling request, pre-submission conferences will be held on a time-available basis, and generally the taxpayer will be requested to provide a draft ruling request or other detailed written description of the proposed transaction prior to the conference. Any discussion of substantive issues at a pre-submission conference is advisory only, is not binding on the Service, and cannot be relied upon as a basis for obtaining retroactive relief under the provisions of section 7805(b) of the Code. A ruling request submitted following the pre-submission conference will not necessarily be assigned to the Branch that held the pre-submission conference.

SEC. 7. WITHDRAWAL OF REQUESTS

A request for a ruling or determination letter may be withdrawn at any time before the signing of the letter of reply. If a request for a ruling is withdrawn, the National Office may give its view on the subject matter of the request to the District Director whose office will have examination jurisdiction over the taxpayer's return for consideration in connection with any later examination of the taxpayer's return. Even though a request is withdrawn, all correspondence and exhibits will be kept by the Service and will not be returned to the taxpayer. In appropriate cases, the Service may publish its findings in a revenue ruling or revenue procedure.

SEC. 8. EFFECT OF RULINGS

Reliance, revocation or modification: section 7805(b) of the Code

.01 A taxpayer may not rely on a ruling issued to another taxpayer. A ruling, except to the extent incorporated in a closing agreement, may be revoked or modified at any time under appropriate circumstances. See section 15.08 for the effect of a closing agreement. If a ruling is revoked or modified, the revocation or modification applies to all years open under the statutes, unless the Commissioner or the Commissioner's delegate exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the revocation or modification. The manner in which the authority generally is exercised is given later in this section. For information on rulings relating to the sale or lease of articles subject to the manufacturer's excise tax and the retailer's excise tax, see section 8.08.

District Director's responsibility

.02 When determining a taxpayer's liability, the District Director must ascertain whether (1) any ruling previously issued to the taxpayer has been properly applied, (2) the representations upon which the ruling was based reflected an accurate statement of the material facts, and (3) the transaction actually was carried out substantially as proposed. If, in the course of determining the tax liability, the District Director finds that a ruling should be modified or revoked, the findings and recommendations of the District Director will be forwarded to the National Office for consideration before further action. Such a referral to the National Office will be treated as a request for technical advice and the procedures of Rev. Proc. 90-2 will be followed. Otherwise, the ruling is to be applied by the District Office in its determination of the taxpayer's liability.

Contrary conclusion by field office

.03 Appropriate coordination with the National Office will be undertaken if any field official having jurisdiction over a return or other matter proposes to reach a conclusion contrary to a ruling previously issued to the taxpayer.

Ways in which a ruling found to be in error is modified or revoked

.04 Except to the extent incorporated in a closing agreement, a ruling found to be in error or not in accord with the current views of the Service may be modified or revoked. Modification or revocation of a ruling may be made by (1) a notice to the taxpayer to whom the ruling was issued, (2) an enactment of legislation or ratification of a tax treaty, (3) a decision of the United States Supreme Court, (4) the issuance of temporary or final regulations, or (5) the issuance of a revenue ruling, a revenue procedure, or other statement published in the Internal Revenue Bulletin. Consistent with these provisions, if a ruling relates to a continuing action or a series of actions, the ruling ordinarily will be applied until any one of the actions described above has taken place, or until specifically withdrawn. Publication of a notice of proposed rulemaking will not affect the application of any ruling issued under the procedures stated in this revenue procedure.

Circumstances in which revocation or modification of a ruling will not be applied retroactively

.05 Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively to the taxpayer for whom the ruling was issued or to a taxpayer whose tax liability was directly involved in the ruling if (1) there has been no statement or omission of material facts, (2) the facts at the time of the transaction are not materially different from the facts on which the ruling was based, (3) there has been no change in the applicable law, (4) the ruling was

originally issued with respect to a prospective or proposed transaction, and (5) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to the taxpayer's detriment. For example, the tax liability of each shareholder is directly involved in a ruling on the reorganization of a corporation. However, the tax liability of members of an industry is not directly involved in a ruling issued to one of the members, and the holding in a revocation or modification of a ruling to one member of an industry may be retroactively applied to other members of the industry. By the same reasoning, a tax practitioner may not obtain the nonretroactive application to one client of a modification or revocation of a ruling previously issued to another client. If a ruling is revoked by letter with retroactive effect, the letter will, except in fraud cases, state the grounds upon which the revocation is being made and the reasons why the revocation is being applied retroactively.

Application of ruling restricted to transaction; not affected by regulations issued later

.06 A ruling issued on a particular transaction represents a holding of the Service on that transaction only. Furthermore, except in rare or unusual circumstances, the application of that ruling to the transaction will not be affected by the later issuance of regulations (either temporary or final), if the conditions specified in section 8.05 are met. However, if the ruling is later found to be in error or no longer in accord with the position of the Service, it will not give the taxpayer protection for a like transaction in the same year or later year.

Retroactivity; ruling on continuing or series of actions, illustrations

.07 If a ruling is issued covering a continuing action or series of actions and it is determined that the ruling was in error, or no longer in accord with the position of the Service, the Associate Chief Counsel (Technical) ordinarily will limit the retroactivity of the revocation or modification to a date that is not earlier than that on which the ruling is modified or revoked. To illustrate, if a taxpayer receives a ruling that certain payments are excludable from gross income for federal income tax purposes and it is later determined that the ruling is in error or no longer in accord with the position of the Service, the Associate Chief Counsel (Technical) ordinarily will restrict the retroactive application of the revocation or modification of the ruling. If a taxpayer rendered service or provided a facility that is subject to the excise tax on services or facilities, and in reliance on a ruling issued to the same taxpayer did not pass the tax on to the user of the service or the facility, the Associate Chief Counsel (Technical) ordinarily will restrict retroactive application of the revocation or modification of the ruling. If an employer incurred liability under the Federal Insurance Contributions Act, but in reliance on a ruling made to the same employer, neither collected the employee tax nor paid the employee and employer taxes under the Act, the Associate Chief Counsel (Technical) ordinarily will restrict the retroactive application of the revocation or modification of the ruling for both the employer tax and the employee tax. In the last situation, however, the restriction of retroactive application ordinarily will be conditioned on the furnishing by the employer of wage data, as may be required by section 31.6011(a)-1 of the Employment Tax Regulations.

Retroactively; sale or lease subject to excise tax

.08 A ruling holding that the sale or lease of a particular article is subject to the manufacturer's excise tax or the retailer's excise tax may not retroactively revoke or modify an earlier ruling holding that the sale or lease of such an article was not taxable, if the taxpayer to whom the ruling was issued, in reliance upon the earlier ruling, parted with possession or ownership of the article without passing the tax on to the customer. Section 1108(b), Revenue Act of 1926.

Retroactively; completed transaction

.09 For rulings involving completed transactions other than those described in sections 8.07 and 8.08, taxpayers will not be given the protection against retroactive revocation provided in section 8.05, since they will not have entered into the transactions in reliance on the ruling.

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SEC. 9. PROCEDURES FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF RULINGS

Application of section 7805(b) of the Code

.01 Pursuant to section 7805(b) of the Code, it is within the discretion of the Commissioner or the Commissioner's delegate to prescribe the extent, if any, to which any ruling (including determination letters) will be applied without retroactive effect.

A taxpayer to whom a ruling or determination letter has been issued may request that the Associate Chief Counsel (Technical), the Commissioner's delegate, exercise the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of any subsequent revocation or modification of the ruling or determination letter.

Form of request to limit the retroactive effect of a modification or revocation of a ruling letter

.02 In the case of a ruling, a request to limit the retroactive effect of the revocation or modification of a ruling must be in the form of, and meet the requirements for, a ruling request generally. These requirements are set forth in section 3 of this revenue procedure. Specifically, the request must state that it is being made pursuant to section 7805(b) of the Code, contain a statement of the relief sought and an explanation of the reasons and arguments in support of the relief requested, and also be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 8.05 of this revenue procedure as they relate to the taxpayer's particular situation.

A request for the application of section 7805(b) of the Code may take the form of a separate request for a ruling when, for example, a revenue ruling has the effect of modifying or revoking a ruling previously issued to the taxpayer or when the Service notifies the taxpayer of a change in position that will have the effect of revoking or modifying such a ruling. However, when such notice is given by the District Director during the course of an examination of the taxpayer's return, or during consideration by the Chief, Appeals Office, a request to limit the retroactive effect of the modification or revocation of a ruling must be made in the form of a request for technical advice. See section 10.03 of Rev. Proc. 90–2.

When germane to a pending ruling request, a request for the application of section 7805(b) may be made as part of the request, either initially or at any time before the ruling is issued. When a ruling that concerns a continuing transaction is modified or revoked by, for example, a subsequent revenue ruling, a request to limit the retroactive effect of the modification or revocation of the ruling must be made before the return is examined that contains the transaction that is the subject of the request for a ruling.

Taxpayer's right to conference

.03 When a request for the application of section 7805(b) of the Code is made in a separate ruling request, the taxpayer has the right to a conference in the National Office in accordance with the provisions of section 6 of this revenue procedure. If the request is made initially as part of a pending ruling request or is made before the conference of right is held on the substantive issues, the section 7805(b) issue will be discussed at the taxpayer's one conference of right. (See section 6.05 of this revenue procedure). If the request for the application of section 7805(b) is made as part of a pending ruling request after a conference has been held on the substantive issue, and the Service determines that there is justification for having delayed the request, then the taxpayer will have the right to one conference of right concerning the application of section 7805(b) with the conference limited to discussion of this issue.

SEC. 10. DETERMINATION LETTERS ISSUED BY DISTRICT DIRECTOR

In general

.01 District Directors issue determination letters only if the question presented is specifically answered by statute or regulation, or by a position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin.

In income and gift tax matters

1. *In income and gift tax matters*, District Directors issue determination letters in response to taxpayers' written requests on completed transactions that affect returns over which they have examination jurisdiction. A determination letter usually is not issued for a question concerning a return to be filed by the taxpayer if the same question is involved in a return already filed. District Directors do not issue determination letters on the tax consequences of prospective or proposed transactions, except as provided in section 10.03.

In estate tax matters

2. *In estate tax matters*, District Directors issue determination letters in response to written requests affecting the estate tax returns over which they have examination jurisdiction. District Directors do not issue determination letters on matters concerning the application of the estate tax to property or the estate of a living person.

In generation-skipping transfer tax matters

3. *In generation-skipping transfer tax matters*, District Directors issue determination letters in response to written requests affecting the generation-skipping transfer tax returns over which they have examination jurisdiction. District Directors do not issue determination letters on matters concerning the application of the generation-skipping transfer tax before the distribution or termination takes place.

In employment and excise tax matters

4. *In employment and excise tax matters*, District Directors issue determination letters on completed transactions in response to written requests from taxpayers over which they have examination jurisdiction.

Letters not issued by District Director

.02 Notwithstanding the provisions of section 10.01, even though a request presents a question specifically answered by statute or regulation, or by a position stated in a ruling, opinion or court decision published in the Internal Revenue Bulletin, a District Director will not issue a determination letter in response to the request if (1) it appears that the taxpayer has directed a similar inquiry to the National Office, (2) the same issue involving the same taxpayer is pending in a case in litigation or before an Appeals Office, (3) the determination letter is requested by an industry, trade association, or similar group, or (4) the request involves an industry-wide problem. Under no circumstances will a District Director issue a determination letter unless it is clearly shown that the request concerns a return which has been filed or is required to be filed and over which the District Director has or will have examination jurisdiction. Notwithstanding the provisions of section 10.01, a District Director will not issue a determination letter on an employment tax question if the specific question for the same taxpayer has been or is being considered by the Central Office of the Social Security Administration or the Railroad Retirement Board. Nor will District Directors issue determination letters for determination of a constructive sales price under section 4216(b) or 4218(c) of the Code. The National Office, however, will issue rulings in this area. See section 18.05.

Letters issued under section 1033 of the Code

.03 District Directors issue determination letters on the replacement of involuntarily converted property under section 1033 of the Code even though the replacement has not been made if the taxpayer has filed an income tax return for the year in which the property was involuntarily converted.

Requests concerning income, estate or gift tax returns

.04 A request received by a District Director on a question concerning an income, estate, or gift tax return already filed will be, in general, considered in connection with the examination of the return. If a response is made to such a request before the return is examined, it will be considered a tentative finding in any later examination of that return.

Office where request for determination letter should be sent

.05 A request for a determination letter should be sent to the District Director of Internal Revenue whose office has or will have examination jurisdiction over the taxpayer's return.

Attach a copy of determination letter to taxpayer's return

.06 A taxpayer who receives a determination letter before filing a return about any transaction that has been consummated and that is relevant to the return being filed should attach a copy of the determination letter to the return when it is filed.

SEC. 11. REVIEW OF DETERMINATION LETTERS

Determination letters issued under section 10.01 are not reviewed by the National Office before they are issued. If a taxpayer believes that a determination letter of this type is in error, the taxpayer may ask the District Director to reconsider the matter. The taxpayer may also ask the District Director to request technical advice from the National Office. In such an event the procedures in Rev. Proc. 90-2 must be followed.

SEC. 12. EFFECT OF DETERMINATION LETTERS

A determination letter issued by a District Director has the same effect as a ruling issued to a taxpayer under section 8 of this revenue procedure. However, if the District Director is of the opinion that a conclusion contrary to that expressed in the determination letter is indicated, the matter need not be referred to the National Office. A District Director may not limit the modification or revocation of a determination letter but may refer the matter to the National Office for the possible exercise by the Commissioner or the Commissioner's delegate of the authority to limit the modification or revocation.

SEC. 13. PROCEDURES FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF DETERMINATION LETTERS

Form of request to limit the retroactive effect of a modification or revocation of a determination letter

.01 In the case of a determination letter that the District Director proposes to modify or revoke, a request to limit the modification or revocation of the determination letter must be made by requesting the District Director who issued the determination letter to seek technical advice from the National Office, since a District Director has not been delegated authority under section 7805(b) of the Code to limit the modification or revocation of a determination letter. See section 9.01 of this revenue procedure and section 10.03 of Rev. Proc. 90-2. The taxpayer's request must state that it is being made pursuant to section 7805(b), contain a statement of the relief sought and an explanation of the reasons and arguments in support of the relief requested, and also be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 8.05 of this revenue procedure as they relate to the taxpayer's particular situation.

Taxpayer's right to a conference when technical advice is requested

.02 When technical advice is requested with respect to the application of section 7805(b) of the Code under the circumstances set forth in section 13.01 above, the taxpayer has the right to a conference in the National Office to the same extent as does any taxpayer who is the subject of a technical advice request. See section 6 of Rev. Proc. 90-2.

SEC. 14. EFFECT OF INFORMATION LETTERS

An information letter issued by the National Office or by a District Director is advisory only, and the provisions of section 8 do not apply.

PART II—GENERAL

SEC. 15. GENERAL PRACTICE AND DEFINITIONS

Issuance of rulings by National Office

.01 The Service answers inquiries of individuals and organizations, when appropriate in the interest of sound tax administration, about their status for tax purposes and the tax effects of their acts or transactions. The National Office issues rulings in such matters.

Issuance of determination letters by District Director

.02 District Directors of the Internal Revenue Service apply the statutes and tax treaties, regulations, revenue rulings, and other precedents published in the Internal Revenue Bulletin in determining tax liability, collecting taxes, and issuing information letters and determination letters in answer to taxpayers' inquiries or requests. For purposes of this revenue procedure, any reference to District Director or District Office includes their respective offices or, when appropriate, the Director of an Internal Revenue Service Center.

Taxpayer

.03 The word "taxpayer" includes all persons subject to any provision of the Code (including issuers of section 103 obligations) and, when appropriate, their representatives. Any reference to National Office herein means only the Office of the Associate Chief Counsel (Technical).

Ruling

.04 A "ruling" is a written statement issued to a taxpayer by the National Office that interprets and applies the tax laws to that taxpayer's specific set of facts. Rulings are issued only by the National Office, under the general supervision of the Associate Chief Counsel (Technical). Issuing rulings has been largely delegated to the Assistant Chief Counsel (Corporate), the Assistant Chief Counsel (Employee Benefits and Exempt Organizations), the Assistant Chief Counsel (Financial Institutions and Products), the Assistant Chief Counsel (Income Tax and Accounting), and the Assistant Chief Counsel (Passthroughs and Special Industries).

Determination letter

.05 A "determination letter" is a written statement issued by a District Director in response to a written inquiry by a taxpayer that applies the principles and precedents previously announced by the National Office to a specific set of facts. A determination letter is issued only when a determination can be made on the basis of clearly established rules in the statute or regulations, or by a position in a ruling, opinion, or court decision published in the Internal Revenue Bulletin that specifically answers the question presented. A determination letter will not be issued if a determination cannot be made, for example, when the question presents a novel issue, or if the matter is excluded from the jurisdiction of a District Director under section 10 of this revenue procedure.

Information letter

.06 An "information letter" is a statement issued either by the National Office or by a District Director that calls attention to a well-established interpretation or principle of tax law, without applying it to a specific set of facts. It may be issued if the request indicates that the taxpayer is seeking general information. If the request does not meet the requirements of section 3 of this revenue procedure, but the Service thinks that the general information may help the individual or organization, it may issue an information letter.

Revenue ruling

.07 A "revenue ruling" is an interpretation by the Service that has been published in the Internal Revenue Bulletin. It is the conclusion of the Service on how the law is applied to an entire set of facts. Revenue rulings are issued only by the National Office and are published for the information and guidance of taxpayers, Internal Revenue Service officials, and other interested parties.

Since each revenue ruling represents the conclusion of the Service as to the application of law to the entire statement of facts involved, taxpayers, Service personnel, and others concerned are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same. They should consider the effect of subsequent legislation, regulations, court decisions, and revenue rulings. See Rev. Proc. 89-14, 1989-1 C.B. 814, which states the objectives of and standards for the publication of revenue rulings and revenue procedures in the Internal Revenue Bulletin.

Closing agreement

.08 A "closing agreement" is an agreement between the Commissioner of Internal Revenue or the Commissioner's delegate and a taxpayer on a specific issue or issues or liability that is entered into under the authority in section 7121 of the Code. Closing agreements are final, unless fraud, malfeasance, or misrepresentation of a material fact can be shown.

A closing agreement prepared in an office under the responsibility of the Associate Chief Counsel (Technical) is based on a ruling that has been signed by the Commissioner or the Associate Chief Counsel (Technical) that says that a closing agreement will be entered into on the basis of the holding of the ruling letter. Closing agreements may be entered into when it is advantageous to have the matter permanently and conclusively closed, or when a taxpayer can show good and sufficient reasons for an agreement and the government will sustain no disadvantage by its consummation. In appropriate cases, taxpayers may be asked to enter into a closing agreement as a condition to the issuing of a ruling.

If, in a single case, closing agreements are requested for each of a number of taxpayers, such agreements are entered into only if the number of taxpayers is 25 or less. However, if the issue and holding are identical for all taxpayers and they number more than 25, a "mass closing agreement" will be entered into with the taxpayer who is authorized by the others to represent the entire group.

SEC. 16. ORAL ADVICE TO TAXPAYERS

Discuss substantive and procedural tax issues

.01 The Service does not issue rulings or determination letters on oral requests. However, personnel in the branches ordinarily will discuss with taxpayers or their representatives inquiries regarding: substantive tax issues; whether the Service will rule on particular issues; and questions relating to procedural matters about submitting ruling requests (including the application of section 3 of this revenue procedure to a particular case). Any discussion of substantive issues will be at the discretion of the Service on a time available basis, will not be binding on the Service, and cannot be relied upon as a basis of obtaining retroactive relief under the provisions of section 7805(b) of the Code. Substantive tax issues involving the taxpayer that are under examination or in litigation will not be discussed by Service personnel not directly involved in the examination or litigation of such issues. However, a tax issue may be discussed even though the issue is affected by a nontax issue pending in litigation.

Technical assistance from District Office or Service Center

.02 A taxpayer may seek oral technical assistance from a Taxpayer Service Representative in a District Office or Service Center when preparing a return or report, under other established procedures. Oral advice is advisory only, and the Service is not bound to recognize it in the examination of the taxpayer's return.

SEC. 17. RULINGS ISSUED BY THE NATIONAL OFFICE

In income and gift tax matters—when rulings will be issued on consummated transactions, section 1.9100-1 requests, and specific procedures for accounting period and method changes

01. *In income and gift tax matters,* the National Office issues rulings on prospective transactions and on completed transactions if the request is submitted before the return is filed for the year in which the transaction that is the subject of the request was consummated. However, see Rev. Proc. 79-63, 1979-2 C.B. 578, which concerns applications for relief under section 1.9100-1 of the regulations, and section 18 of this revenue procedure. If a request for an extension of time under section 1.9100-1 is submitted after the return is filed but before the return is examined, the procedures under Rev. Proc. 90-1 are applicable. If an examination of the return has begun, or is being considered by an Appeals Office, the procedures of Rev. Proc. 90-2, this Bulletin, are applicable.

The National Office ordinarily does not issue rulings if, at the time theruling is requested, the identical issue is involved in the taxpayer's return for an earlier period, and (1) that issue is being examined by a District Director, is being considered by an Appeals Office, or is pending in litigation in a case involving the taxpayer or related taxpayer, or (2) that issue has been examined by a District Director or considered by an Appeals Office and the statutory period of limitation on either assessment or for filing a claim for refund or credit of tax has not expired, or a closing agreement covering the issue of liability has not been entered into by a District Director or by an Appeals Office. If a return dealing with an issue for a particular year is filed while a request for ruling on that issue is pending, the National Office will issue the ruling unless it is notified by the taxpayer that an examination of that issue or the identical issue on an earlier year's return has been started by a District Director. See section 3.12. However, even if an examination has begun, the National Office ordinarily will issue the ruling if the District Director agrees, by memorandum, to permit the ruling to be issued.

The National Office does not issue rulings on the replacement of involuntarily converted property, whether or not replacement has been made, if the taxpayer has already filed a return for the tax year in which the property was converted. See section 10.03 for the District Director's authority to issue determination letters in this connection. In addition, the National Office generally does not issue rulings on the classification of an organization if a return has been filed for the organization for an earlier period. However, the National Office will consider ruling requests concerning the classification of an existing organization as a partnership. See Rev. Proc. 86-12, 1986-1 C.B. 534, and Rev. Proc. 89-12, 1989-1 C.B. 798.

In estate tax matters

In general

.02 *In estate tax matters*

1. *In general,* the National Office issues prospective rulings with respect to transactions affecting the estate tax of a living person and rulings with respect to the estate tax of a decedent before the estate tax return is filed. With respect to prospective estate tax rulings, requests involving computations of tax, actuarial factors and factual matters will not be considered.

With respect to ruling requests involving a decedent's estate tax, if the estate tax return is due to be filed before the ruling is issued, the taxpayer should secure an extension of time for filing the return for the maximum period of six months, and notify the National Office Branch considering the request for ruling that an extension has been secured. If the return is filed before the ruling is issued, the taxpayer must disclose on the return that a ruling has been requested, attach a copy of the pending ruling request to the return, and notify the National Office that the return has been filed. The National Office will make every effort to issue the ruling within three months of the day on which the return was filed. If the ruling cannot be issued within that three month period, the National Office will notify the District Director having jurisdiction of the return who may, by memorandum to the National Office, grant an additional period for the issuance of the ruling.

In matters involving additional tax under section 2032A(c) of the Internal Revenue Code

2. *In matters involving additional tax under section 2032A(c),* the National Office issues rulings on prospective transactions and on completed transactions that occurred before the return is filed for the year in which such transactions are consummated.

In generation-skipping transfer tax matters

.03 *In generation-skipping transfer tax matters,* in general, the National Office issues rulings on prospective transactions that affect the generation-skipping transfer tax and completed transactions before the return is filed. In the case of a generation-skipping trust, or trust equivalent, rulings are issued either before or after the trust or trust equivalent has been established. Rulings may be issued on a generation-skipping transfer tax matter before a "direct skip" transfer, taxable distribution, or taxable termination takes place. The National Office will issue rulings regarding the application of the generation-skipping transfer tax effective date rules (section 1433 of the Tax Reform Act of 1986, 1986-3 C.B. 648, Vol. 1) to wills, trusts and trust equivalents in existence on October 22, 1986, and to generation-skipping transfers taking place on or before October 22, 1986.

In employment and excise tax matters

.04 *In employment and excise tax matters,* the National Office issues rulings on prospective transactions and on completed transactions either before or after the return is filed for those transactions. In employment tax matters, generally the taxpayer is the employer. However, if the worker asks for the ruling, both the worker and the employer are considered to be the taxpayer and both are entitled to the ruling. The National Office usually will not issue rulings if, at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period and (1) that issue is being examined by a District Director, is being considered by an Appeals Office, or is pending in litigation in a case involving the taxpayer or related taxpayer, or (2) that issue has been examined by a District Director or considered by an Appeals Office and the statutory period of limitation for either assessment or filing a claim for refund or credit of tax has not expired, or a closing agreement covering the issue or liability has not been entered into by a District Director or by an Appeals Office. However, if a District Director began an examination of the issue involved in the ruling request, the National Office usually will issue the ruling if the District Director agrees, by memorandum, to permit the ruling to be issued.

In administrative provisions matters

.05 *In administrative provisions matters,* the National Office issues rulings on issues arising under the Code, and related statutes, and the regulations thereunder, that relate primarily to the time, place, manner, and procedures, for reporting and paying taxes; assessing and collecting taxes (including interest and penalties); abating, crediting, or refunding overassessments or overpayments of tax; and filing information returns. Rulings ordinarily are not issued if, at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period and (1) that issue is being examined by a District Director, is being considered by an Appeals Office, is pending in litigation in a case involving the taxpayer or a related taxpayer or (2) that issue has been examined by a District Director or considered by an Appeals Office and the statutory period of limitation for either assessment or filing a claim for refund or credit of tax has not expired, or a closing agreement covering the issue or liability has not been entered into by a District Director or Appeals Office. If a return involving an issue for a particular year is filed while a request for a ruling on that issue is pending, the National Office will issue the ruling unless an examination of that issue or an examination of the identical issue on an earlier year's return has been started by a District Director. But, even if consideration has begun, the National Office ordinarily will issue the ruling if the District Director agrees, by memorandum, to permit the ruling to be issued.

Rulings to business associations or groups

.06 The National Office does not issue rulings to business, trade, or industrial associations or to similar groups concerning the application of the tax laws to members of the group. It may, however, issue rulings to these groups or associations on their own tax status or liability if the request meets the requirements of this section. Furthermore, such groups or associations may submit suggestions of generic issues that would be appropriately addressed in revenue rulings.

Rulings pending adoption of regulations

.07 Pending the adoption of regulations (either temporary or final) that interpret the provisions of any act, the issuing of rulings will be considered under the following conditions.

Answer is clear

1. If the ruling request presents an issue on which the answer seems clear by applying the statute to the facts, a ruling will be issued under the usual procedures.

Answer reasonably certain

2. If the ruling request presents an issue on which the answer seems reasonably certain but not entirely free from doubt, a ruling will be issued.

Issues covered by Rev. Proc. 88-18

3. Section 2.02 of Rev. Proc. 88-18, 1988-1 C.B. 694, provides that for Code sections enacted or amended by the Tax Reform Act of 1986 or the Revenue Act of 1987 the appropriate Branch will entertain all ruling requests and do its best to issue a ruling even if the answer does not seem reasonably certain.

However, if the ruling request presents an issue that cannot be readily resolved before regulations are issued, a ruling will not be issued. However, section 2.03 of Rev. Proc. 88-18 provides that when the Service has closed a regulations project or does not intend to open a regulations project, the appropriate Branch will entertain all ruling requests unless the issue is covered (currently) by section 18 of Rev. Proc. 90-1 or by Rev. Proc. 90-3, also in this Bulletin.

SEC. 18. DISCRETIONARY AUTHORITY TO ISSUE RULINGS AND DETERMINATION LETTERS

General no rule areas

.01 The Service ordinarily will not issue rulings or determination letters in certain areas because of the factual nature of the problem involved, or for other reasons. Rev. Proc. 90-3, in this Bulletin, provides a list of these areas. This list is not all inclusive, since the Service may decline to issue a ruling or a determination letter on other grounds, whenever warranted by the facts or circumstances of a particular case. The National Office and District Directors may, when it is considered appropriate and in the best interest of the Service, issue information letters calling attention to well-established principles of tax law.

Specific no rule areas where issues are clearly addressed by published authorities

.02 With respect to all ruling requests postmarked or, if not mailed, received on or after May 7, 1990, the National Office ordinarily will not issue a ruling with respect to an issue that is clearly and adequately addressed by a statute, regulation, decision of the Supreme Court, tax treaty, revenue ruling, revenue procedure, notice, or other authority published in the Internal Revenue Bulletin, except in extraordinary circumstances (e.g., a request for a ruling required by a governmental regulatory authority in order to effectuate a transaction). See section 3.10 for a statement to be included in a request for ruling. However, the National Office will issue an information letter, as defined in section 15.06, if it believes that providing general information would be helpful.

No ruling on alternative plans or hypothetical situations

.03 A ruling or a determination letter is not issued on alternative plans of proposed transactions or on hypothetical situations.

Ordinarily no ruling on only part of an integrated transaction

.04 The National Office ordinarily will not issue rulings on only part of an integrated transaction.

Constructive sales price under section 4216(b) or 4218(c) of the Code

.05 The National Office will issue rulings in all cases on the determination of a constructive sales price under section 4216(b) or 4218(c) of the Code and in all other cases on prospective or future transactions if the law or regulations require a determination of the effect of a proposed transaction for tax purposes.

SEC. 19. DISTRICT OFFICE REFERRAL OF MATTERS TO THE NATIONAL OFFICE

Request for determination letters

.01 Requests for determination letters received by District Directors that, under the provisions of this revenue procedure, may not be acted upon by a District Office, will be forwarded to the National Office for reply. The District Office will let the taxpayer know that this action has been taken. District Directors will also refer to the National Office any request for a determination letter that in their judgement should have the attention of the National Office.

No rule areas

.02 If the request involves an issue on which the Service will not issue a ruling or determination letter, the request will not be forwarded to the National Office. The District Office will let the taxpayer know that the Service will not issue a ruling or a determination letter on the issue. See section 18.01 of this revenue procedure.

SEC. 20. REFERRAL OF MATTERS TO DISTRICT OFFICES

Requests for rulings received by the National Office that, under section 17 of this revenue procedure, may not be acted upon by the National Office will be forwarded to the District Office that has examination jurisdiction over the taxpayer's return. The taxpayer will be notified of this action. If the request is on an issue or in an area of the type discussed in section 18.01 and it is decided not to issue a ruling or an information letter, the National Office will let the taxpayer know, and the request will then be forwarded to the appropriate District Office for association with the related return.

SEC. 21. CHANGES

.01 Page numbers have been assigned to the principal headings of the table of contents and the format of the text and the sequence of the sections of Rev. Proc. 89-1 have been changed in an effort to make this document (Rev. Proc. 90-1) easier to read and apply.

.02 A new section 4 is added to provide in one location and in an easier to read format the guidelines for requesting rulings under certain Code sections and pertaining to certain subject matters.

.03 Sections 3 and 18 and amended to incorporate those changes made by Rev. Proc. 89-34, 1989-1 C.B. 917, as modified by Rev. Proc. 89-51, 1989-2 C.B. 632. Those revenue procedures, provide that as of February 5, 1990 the Service will discontinue the issuance of letter rulings with respect to issues that are clearly and adequately addressed by authorities published in the Internal Revenue Bulletin, except in extraordinary circumstances. Announcement 89-105, 1989-35 I.R.B. 20, answers a number of commonly asked questions concerning Rev. Proc. 89-34, including how the "comfort ruling" policy described therein is to be administered. Announcement 89-104, 1989-35 I.R.B. 19, requests public comment with respect to possible modifications of the "comfort ruling" policy. Any changes to that policy that may result from comments received in respect of Announcements 89-104 and 89-105 will be included in a separate revenue procedure.

.04 Sections 10 and 17 are amended to provide that determination and ruling letters will not be issued if the issue is pending in litigation for an earlier period.

.05 Section 16.01 is amended to provide that substantive tax issues under examination or in litigation will not be discussed by Service personnel not directly involved in the examination or litigation, except that tax issues will be discussed even though the issue is affected by nontax issues in litigation.

.06 Pursuant to Announcement 89-153, 1989-49 I.R.B. 22, section 17.02 is amended to adopt the ruling policy that previously had been set forth only for a test period in Rev. Proc. 88-50, 1988-2 C.B. 711, whereby the National Office will consider prospective estate tax rulings on all issues, with certain limited exceptions.

.07 Section 17.03 is amended to provide that the National Office will consider prospective rulings involving the generation-skipping tax before a trust or trust equivalent has been established.

SEC. 22. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 89-1, as modified by Rev. Proc. 89-34 and Rev. Proc. 89-51, is superseded.

PART I—PROCEDURES

CONTENTS

SECTION 1. PURPOSE	**p. 388**		
SECTION 2. SCOPE	**p. 388**	.01	Jurisdiction of Associate Chief Counsel (Technical)
		.02	Matters under the Bureau of Alcohol, Tobacco and Firearms
		.03	Matters under the Assistant Commissioner (Employee Plans and Exempt Organizations)
		.04	Farmers' Cooperatives
		.05	Shipowners' Protection and indemnity associations and certain homeowners associations
		.06	Delegation of authority to issue technical advice
SECTION 3. REQUESTING TECHNICAL ADVICE	**p. 389**	.01	Responsibility for determining whether to request technical advice
		.02	Taxpayer notified
		.03	Taxpayer agreement
		.04	Service agreement
		.05	Taxpayer's position
		.06	Taxpayer's right to conference
		.07	Time to make proposed section 6110 deletions
		.08	Section 6104 of the Code
		.09	Section 6110 deletion statement
		.10	Criminal or civil fraud cases
		.11	Section 1.9100-1 of the Income Tax Regulations
		.12	Form 4463, Request for Technical Advice
		.13	Power of attorney
SECTION 4. APPEAL BY TAXPAYERS OF DISTRICT OR APPEALS OFFICE DETERMINATION NOT TO SEEK TECHNICAL ADVICE	**p. 392**	.01	Taxpayer notification of decision not to seek technical advice
		.02	Taxpayer appeal of decision not to seek technical advice
		.03	Statements of taxpayer and examining officer or Appeals Officer
		.04	Review of proposed denial of technical advice request
		.05	Review of denial where authority has been delegated to another official
SECTION 5. WITHDRAWAL OF REQUESTS	**p. 393**	.01	Taxpayer notification
		.02	National Office views

SECTION 6. CONFERENCES IN THE NATIONAL OFFICE	p. 393	.01	Scheduling
		.02	One conference of right
		.03	Attendance by examining officer or Appeals Officer
		.04	Conference delayed to address together the substantive issues and request for section 7805(b) relief
		.05	No tape or other verbatim recording
		.06	Tentative recommendations
		.07	Additional conferences
		.08	Post-conference submissions
		.09	Status request by taxpayer
		.10	Status request by the District Director or Chief, Appeals Office
SECTION 7. PREPARATION OF TECHNICAL ADVICE MEMORANDUM BY THE NATIONAL OFFICE	p. 395	.01	Analyze file
		.02	Branch representative informs District or Appeals Office that either: (a) case being returned (b) additional information needed, (c) tentative conclusion given, or (d) date estimated for tentative conclusion
		.03	Branch representative contact with District or Appeals Office
		.04	District or Appeals Office advised that preliminary conclusion not final
		.05	Multiple issue request
		.06	Request for additional information
		.07	Copy of additional information sent to District Director or Chief, Appeals Office
		.08	Deleted material
		.09	Form and routing of replies
		.10	Two parts to replies
		.11	When copy of technical advice given to taxpayer
		.12	Protest under section 6110 of the Code
SECTION 8. ACTION ON TECHNICAL ADVICE IN DISTRICT AND APPEALS OFFICES	p. 398	.01	Processing of the case
		.02	Copy to the taxpayer
		.03	No copy to the taxpayer
SECTION 9. EFFECT OF TECHNICAL ADVICE	p. 398	.01	Retroactive effect
		.02	Modification or revocation of prior technical advice
		.03	Continuing action or series of actions—how modified or revoked
		.04	Conditions for nonretroactivity

SECTION 10. PROCEDURES FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF TECHNICAL ADVICE	p. 399	.01	Application of section 7805(b) of the Code
		.02	Form of request to limit retroactivity for a continuing transaction
		.03	Form of request to limit retroactivity—during course of an examination
		.04	Form of request to limit retroactivity—technical advice that does not modify or revoke prior memorandum
		.05	Taxpayer's right to a conference

PART II—GENERAL

SECTION 11. DEFINITION AND NATURE OF TECHNICAL ADVICE	p. 401	.01	Taxpayer
		.02	National Office
		.03	District Director
		.04	Technical Advice
		.05	Section 521 of the Code
		.06	Revocation of ruling letter
		.07	When technical advice can be requested
SECTION 12. CHANGES	p. 402		
SECTION 13. EFFECT ON OTHER DOCUMENTS	p. 402		

PART I—PROCEDURES

SECTION 1. PURPOSE

The purpose of the revenue procedure is to update Rev. Proc. 89-2, 1989-1 C.B. 753, which provides revised procedures for furnishing technical advice to District Directors and Chiefs of Appeals Offices by the Associate Chief Counsel (Technical). It also tells taxpayers about their rights when a District Director or a Chief, Appeals Officer, requests such advice. Changes to this revenue procedure will be incorporated annually in a new revenue procedure published as the second revenue procedure of the year.

SEC. 2. SCOPE

Jurisdiction of Associate Chief Counsel (Technical)

.01 The Chief Counsel through the Associate Chief Counsel (Technical) provides principles and rules for uniformly interpreting and applying the federal tax laws under the jurisdiction of the Associate Chief Counsel (Technical). The procedures

for obtaining technical advice on specific issues involving the interpretation or application of the federal income tax laws and income tax treaties relating to international transactions are not contained in this revenue procedure but are contained in Rev. Proc. 87-5, 1987-1 C.B. 535, as modified by Rev. Proc. 88-4, 1988-1 C.B. 586.

Matters under the Bureau of Alcohol, Tobacco and Firearms

.02 The procedures for obtaining technical advice specifically applicable to federal firearms, alcohol and tobacco taxes under subtitle E of the Internal Revenue Code are under the jurisdiction of the Bureau of Alcohol, Tobacco and Firearms.

Matters under the Assistant Commissioner (Employee Plans and Exempt Organizations)

.03 The procedures for obtaining technical advice specifically on issues under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations) are found in Rev. Proc. 80-26, 1980-1 C.B. 671, as modified by Rev. Proc. 83-41, 1983-1 C.B. 775.

Farmers' Cooperatives

.04 The procedures that apply to technical advice for employee plans and exempt organizations are followed in obtaining technical advice on exemption of farmers' cooperatives from tax under section 521 of the Code, even though the Associate Chief Counsel (Technical) has jurisdiction for issuing technical advice under the section.

Shipowners' protection and indemnity associations and certain homeowners associations

.05 The Associate Chief Counsel (Technical) also has the jurisdiction for issuing technical advice under section 526, (shipowners' protection and indemnity associations) and section 528 (certain homeowners associations) and the provisions of this revenue procedure (Rev. Proc. 90-2) are followed in obtaining technical advice on these matters.

Delegation of authority to issue technical advice

.06 In the Office of the Associate Chief Counsel (Technical), the authority to issue technical advice has been largely redelegated to the Branch Chiefs in the offices of the Assistant Chief Counsel (Corporate), the Assistant Chief Counsel (Employee Benefits and Exempt Organizations), the Assistant Chief Counsel (Financial Institutions and Products), the Assistant Chief Counsel (Income Tax and Accounting), and the Assistant Chief Counsel (Passthroughs and Special Industries).

SEC. 3. REQUESTING TECHNICAL ADVICE

Responsibility for determining whether to request technical advice

.01 The District Director or Chief, Appeals Office, is responsible for determining whether to request technical advice on any issue being considered. Each request must be submitted through channels and signed by a person who is authorized to sign for the District Director or Chief, Appeals Office, and should include, in writing, a statement of applicable law and the arguments submitted by the District or Appeals Office in support of its position on the issue or issues. All requests for technical advice from an Appeals Office should be submitted to the Associate Chief Counsel (Technical) through the National Director of Appeals, CC:AP:FS. However, while the case is under the jurisdiction of the District Director or the Chief, Appeals Office, a taxpayer may request that an issue be referred to the National Office for technical advice.

All requests for technical advice should be made at the earliest possible stage of the proceedings. The grounds for a request are that a lack of uniformity exists on the disposition of the issue or that the issue is unusual or complex enough to warrant consideration by the National Office. Taxpayers may also request technical advice when seeking an extension of time fixed by regulations for making an

election or application for relief pursuant to section 1.9100–1 of the Income Tax Regulations. See section 3.11 of this revenue procedure for additional information.

Although taxpayers are encouraged to make written requests setting forth the facts, law, and argument on the issue, and reasons for requesting National Office technical advice, they may make the request orally. If, after considering the taxpayer's request, the examining officer or Appeals Officer thinks that the circumstances do not warrant referral of the case to the National Office, the examining officer or Appeals Officer will tell the taxpayer (see section 4 for taxpayer's appeal rights when an examining officer or an Appeals Officer declines to request technical advice).

Taxpayer notified

.02 When technical advice is going to be requested, whether or not at the request of the taxpayer, the taxpayer will be told about it and given a copy of the arguments submitted by the District Director or Chief, Appeals Office, in support of its position on the issue or issues, except as noted in section 3.10. If the examining officer or the Appeals Officer initiates the action, the Service will give the taxpayer a copy of the statement of the pertinent facts and the questions proposed for submission to the National Office. The request for technical advice should be worded to avoid possible misunderstanding in the National Office of the facts or the specific points at issue.

Taxpayer agreement

.03 If the Service initiates the request for technical advice, the taxpayer has 10 calendar days after receiving the statement of facts and specific questions to indicate in writing any disagreement about them. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office. Every effort should be made to reach agreement on the facts and the specific points at issue. If agreement cannot be reached, the taxpayer may send, within 10 calendar days after receipt of notice, a statement of the taxpayer's understanding of the new specific points at issue. This statement will be forwarded to the National Office with the request for technical advice. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office. When the District Director or the Chief, Appeals Office, and the taxpayer cannot agree on material facts, the National Office, at its discretion, may refuse to provide technical advice.

Service agreement

.04 If the taxpayer initiates the action to request technical advice and the taxpayer's statement of the facts and points at issue are not wholly acceptable to the District or Appeals Office, the Service will tell the taxpayer in writing what the areas of disagreement are. The taxpayer has 10 calendar days after receiving the written notice to reply to it. The taxpayer must justify in writing an extension beyond 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office. If agreement cannot be reached, both the statements of the taxpayer and the District or Appeals Office will be forwarded to the National Office with the request for technical advice. When the disagreement involves material facts essential to the preliminary assessment of the case, the District Director or Chief, Appeals Office, may, at the discretion of such Director or Chief, refuse referral to the National Office of a taxpayer initiated request for technical advice or, alternatively, the National Office may refuse to provide technical advice.

Taxpayer's position

.05 If it has not already been done, the taxpayer may submit a statement explaining the taxpayer's position on the issues and citing precedents that the taxpayer believes will bear on the case. This statement will be forwarded to the National Office with the request for technical advice. If the taxpayer's statement is received after the request for technical advice has been forwarded to the National Office, it will be forwarded there to be associated with the request for technical

advice. The taxpayer is encouraged to comment on any legislation, tax treaties, regulations, revenue rulings, revenue procedures, or court decisions contrary to the taxpayer's position.

Taxpayer's right to conference

.06 At the time the taxpayer is told that the matter is being referred to the National Office, the taxpayer will also be told about the right to a conference in the National Office if an adverse decision is indicated and will be asked to say whether such a conference is desired.

Time to make proposed section 6110 deletions

.07 In connection with requests for technical advice, the taxpayer also has the same 10 days as in section 3.03 and 3.04 to submit the statement described in section 3.09 of proposed deletions under section 6110(c) of the Code. If the taxpayer does not submit the statement, the District Director or the Chief, Appeals Office, will tell the taxpayer that such a statement is required. If the District Director or the Chief, Appeals Office, does not receive that statement within 10 days after such notification, the District Director of the Chief, Appeals Office, may decline to submit the request for technical advice. If the District Director or the Chief, Appeals Office, decides to request technical advice in a case in which the taxpayer has not submitted the statement of proposed deletions, the National Office will make those deletions that the Commissioner determines are required by section 6110(c).

Section 6104 of the Code

.08 The requirements for submitting statements and other materials or proposed deletions in technical advice memoranda before public inspection is allowed do not apply to requests for any documents to which section 6104 of the Code applies.

Section 6110 deletion statement

.09 To help the National Office make the deletions required by section 6110(c) of the Code in technical advice memoranda to be made open to public inspection under section 6110(a), a deletions statement must accompany requests. The statement must either state that no information other than names, addresses, and identifying numbers need be deleted, or if more information is proposed to be deleted, the statement must indicate the deletions proposed by the taxpayer. If the latter alternative is chosen, the statement must be made in a separate document, and it must be accompanied by a copy of all statements of facts and supporting documents that are submitted to the National Office under sections 3.03 and 3.04. The material that the taxpayer wants deleted must be shown in brackets. The statement of proposed deletions must show the statutory basis, under section 6110(c), for each proposed deletion. The statement of proposed deletions must not appear or be referred to anywhere in the request for technical advice. If the taxpayer decides to request additional deletions under section 6110(c) before the National Office replies to the request for technical advice, the taxpayer may submit additional statements. The procedures in this paragraph also apply to additional information submitted during consideration of the technical advice request.

Criminal or civil fraud cases

.10 The provisions of this section (about referring issues upon the taxpayer's request, telling the taxpayer about the referral of issues, giving the taxpayer a copy of the arguments submitted by the District Director or Chief, Appeals Office, in support of its position on the issue or issues, submitting proposed deletions, and granting conferences in the National Office) do not apply to a technical advice memorandum, described in section 6110(g)(5)(A) of the Code, that involves a matter that is the subject of or is otherwise closely related to a criminal or civil fraud investigation or a jeopardy or termination assessment. However, in these cases after all proceedings in the investigations or assessments are complete but before the Commissioner mails, pursuant to section 6110(f)(1), the notice of intention to disclose the technical advice memorandum, a copy of the technical advice memorandum will be furnished to the taxpayer and the taxpayer may provide the statement of proposed deletions to the National Office.

Section 1.9100-1 of the Income Tax Regulations

.11 See Rev. Proc. 79-63, 1979-2 C.B. 578, which concerns applications for extension of time for making an election or application for relief pursuant to section 1.9100-1 of the Income Tax Regulations. If a taxpayer requests an extension of time under section 1.9100-1 during an examination or when the issue is being considered by an Appeals Office, the procedures of Rev. Proc. 90-2 are applicable, except for section 4. The examination officer or Appeals Officer is not authorized to deny consideration of a request for technical advice that involves section 1.9100-1 relief. All such requests must be referred to the National Office. See section 4.03 of Rev. Proc. 79-63.

Form 4463, Request for Technical Advice

.12 Form 4463, Request for Technical Advice, should be used for transmitting requests for technical advice to the National Office.

Power of attorney

.13 Any authorized representative, as described in section 3.16 of Rev. Proc. 90-1, whether or not enrolled to practice, must comply with the conference and practice requirements of the Statement of Procedural Rules (26 CFR 601). Form 2848, Power of Attorney, and Form 2848-D, Authorization and Declaration, may be used with regard to requests for technical advice under this revenue procedure.

SEC. 4. APPEAL BY TAXPAYER OF DISTRICT OR APPEALS OFFICE DETERMINATION NOT TO SEEK TECHNICAL ADVICE

Taxpayer notification of decision not to seek technical advice

.01 If the examining officer or Appeals Officer thinks that a taxpayer's request for referral of an issue to the National Office for technical advice does not warrant referral, the examining officer or Appeals Officer will tell the taxpayer.

Taxpayer appeal of decision not to seek technical advice

.02 The taxpayer may appeal the decision of the examining officer or the Appeals Officer not to request technical advice by submitting to that official, within 10 calendar days after being told of the decision, a statement of the facts, law, and arguments on the issue, and the reasons why the taxpayer believes the matter should be referred to the National Office for technical advice. The taxpayer must justify in writing a request for an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office.

Statements of taxpayer and examining officer or Appeals Officer

.03 The examining officer or the Appeals Officer submits the taxpayer's statement through channels to the Chief, Examination Division, or the Chief, Appeals Office, along with the examining officer's or the Appeals Officer's statement of why the issue should not be referred to the National Office. The Chief determines, on the basis of the statement, whether technical advice will be requested. If the Chief determines that technical advice is not warranted and proposes to deny the request, the taxpayer is told in writing about the determination. In the letter to the taxpayer, the Chief states the reasons for the proposed denial (except in unusual situations when doing so would be prejudicial to the best interests of the Government). The taxpayer has 10 calendar days after receiving the letter to notify the Chief of agreement or disagreement with the proposed denial.

Review of proposed denial of technical advice request

.04 The taxpayer may not appeal the decision of the Chief, Examination Division, or the Chief, Appeals Office, not to request technical advice from the National Office. However, if the taxpayer does not agree with the proposed denial, all data on the issue for which technical advice has been sought, including the

taxpayer's written request and statements, will be submitted to the Assistant Commissioner (Examination) or the National Director of Appeals, as appropriate, for review. If the Assistant Commissioner (Examination) or the National Director of Appeals thinks the circumstances warrant it, he or she may consult the Associate Chief Counsel (Technical) or his or her representatives. After this review, the District Office or the Appeals Office is notified whether the proposed denial is approved or disapproved and, in turn, the District Office or the Appeals Office will notify the taxpayer.

While the matter is being reviewed, the District Office or the Appeals Office suspends action on the issue (except when the delay would prejudice the Government's interest) until such office is notified that the proposed denial is approved or disapproved. This notification is made within 45 calendar days after receipt of the data. The review is made solely on the basis of the written record and no conference is held on the matter.

Review of denial where authority has been delegated to another official

.05 The provisions of this revenue procedure in regard to review of a proposed denial of a request for technical advice continue to be applicable in those situations in which the authority normally exercised by the District Director or Chief, Appeals Office, has been delegated to another official.

SEC. 5. WITHDRAWAL OF REQUESTS

Taxpayer notification

.01 Only a District Director or Chief, Appeals Office, may withdraw a request for technical advice. The withdrawal request may be made at any time before the responding transmittal memorandum is signed. The District Director or Chief, Appeals Office, must notify the taxpayer in writing of an intent to withdraw the request for technical advice except (1) when the period of limitation on assessment is about to expire and the taxpayer has declined to sign a consent to extend the period or (2) when such notification would be prejudicial to the best interests of the Government. If the taxpayer does not agree that the request for technical advice should be withdrawn, the procedure in section 4 of this revenue procedure must be followed.

National Office views

.02 When a request for technical advice is withdrawn, the National Office may send its views to the District Director or the Chief, Appeals Office, when acknowledging the withdrawal request. In an Appeals case, acknowledgment of the withdrawal request should be sent to the appropriate Appeals Office, through the National Director of Appeals, CC:AP:FS. In appropriate cases, the subject matter may be published as a revenue ruling or as a revenue procedure.

SEC. 6. CONFERENCES IN THE NATIONAL OFFICE

Scheduling

.01 If after an analysis of the technical advice request it appears that advice adverse to the taxpayer will be given, and if a conference has been requested, the taxpayer will be told, by telephone if possible, the time and place of the conference.

The conference must be held within 21 calendar days after contact has been made. If conferences are being arranged for more than one request for technical advice for the same taxpayer, they will be scheduled to cause the least inconvenience to the taxpayer.

An extension of the 21-day period will be granted only if the taxpayer justifies it in writing and the Branch Chief, Senior Technician Reviewer, or Assistant to the Branch Chief (or Assistant Branch Chief) of the Branch to which the case is assigned approves it. Because the purpose of these procedures is to facilitate the technical advice process, requests for extensions should be justified by compelling facts and circumstances. The request for extension should be submitted before the end of the 21-day period. If unusual circumstances near the end of the 21-day period make a written request impractical, within the 21-day period the National Office should be told orally about the problem and of the forthcoming written request for extension. These requests must be promptly submitted. The taxpayer or taxpayer's representative will be told promptly and later in writing, of the approval or denial of the requested extension. There is no right to appeal the denial of an extension request. If the Service is not advised of problems with meeting the 21-day period, or if the request is not sent promptly after the National Office is notified of problems with meeting the 21-day period, the case will be processed on the basis of the existing record.

One conference of right

.02 A taxpayer is entitled by right to only one conference in the National Office unless one of the circumstances discussed in section 6.07 exists. This conference is normally held at the Branch level. It is attended by a person who has authority to sign on behalf of the Branch Chief the transmittal memorandum discussed in section 7.10.

When more than one branch has taken an adverse position on an issue within its jurisdiction presented in a request for technical advice, or when the position ultimately adopted by one Branch will affect another Branch's determination, a representative from each Branch with authority to sign for the Branch Chief will attend the conference. If more than one subject is discussed at the conference, the discussion constitutes a conference for each subject.

To promote a free and open discussion of the issues, the conference usually is held after the Branch has an opportunity to study the case. However, the taxpayer may request that the conference of right be held at a stage earlier in the consideration of the case than the Service would ordinarily designate.

The taxpayer has no right to appeal the action of a Branch to an Assistant Chief Counsel or to any other official of the Service.

Attendance by examining officer or Appeals Officer

.03 The examining officer or the Appeals Officer may ask or be requested to attend the conference to clarify the facts in the case.

Conference delayed to address together the substantive issues and request for section 7805(b) relief

.04 In order to issue technical advice memoranda in a more efficient manner, the Branch representatives may offer the taxpayer an option of delaying the conference in order to submit a brief requesting section 7805(b) relief, discussed in section 10 of this revenue procedure, in the event of a final adverse determination by the Service. In such cases, a conference on the tentatively adverse position and the section 7805(b) relief request will be scheduled within 10 days of receipt of the taxpayer's section 7805(b) request.

No tape or other verbatim recording

.05 Because conference procedures are informal, no tape, stenographic, or other verbatim recording of a conference is made.

Tentative recommendations

.06 The senior Service representative at the conference ensures that the taxpayer has full opportunity to present views on all the issues in question. The Service representatives explain the Service's tentative decision on the substantive issues and the reasons for it. If the prospective application under section 7805(b) of the Code is advocated by the taxpayer, the Service representative will discuss the tentative recommendation concerning the request for relief and the reason for the tentative recommendation. No commitment will be made as to the conclusion that the Service will finally adopt on any of the issues.

Additional conferences

.07 An invitation to an additional conference is made if, after the conference of right, an adverse holding is proposed either (1) on a new issue or (2) on the same issue but on grounds different from those discussed at the first conference. When a proposed holding is reversed at a higher level with a result less favorable to the taxpayer, the taxpayer has no right to another conference if the grounds or arguments on which the reversal is based were discussed at the conference of right. The limitation on the number of conferences to which a taxpayer is entitled does not prevent inviting a taxpayer to attend further conferences when National Office personnel think they are necessary. These additional conferences are held only at the invitation of the National Office.

Post-conference submissions

.08 The taxpayer is responsible for furnishing in writing, and in duplicate, to the National Office within 21 calendar days after the conference any additional data, lines of reasoning, procedures, etc. that the taxpayer proposed and that were discussed at the conference but not previously or adequately presented in writing. A copy of the additional material submitted to the taxpayer must be sent by the taxpayer to the District Director or the Chief, Appeals Office, for information and, if appropriate, comment. If the additional information is not received within 21 days, the technical advice memorandum will be issued on the basis of the existing record.

An extension of the 21-day period may be granted only if the taxpayer justifies it in writing and the Branch Chief, Senior Technician Reviewer, or the Assistant to the Branch Chief (or Assistant Branch Chief) of the Branch to which the case is assigned approves it. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those in section 6.01.

If the additional information would have a significant impact on the facts in the request for technical advice, the National Office will ask the District Director or the Chief, Appeals Office, for comment on the facts contained in the additional information submitted. The District Director or the Chief, Appeals Office, will give the material prompt attention.

Status request by taxpayer

.09 A taxpayer may get information on the status of the request for technical advice by contacting the District or Appeals Office that requested the technical advice.

Status request by the District Director or Chief, Appeals Office

.10 A District Director or a Chief, Appeals Office, may get current information on the status of the request for technical advice by calling the person whose name and telephone number are shown on the acknowledgement of receipt of his or her request for technical advice or the Branch representative described in section 7.02, below. The District Director or the Chief, Appeals Office, will be notified at the time the technical advice memorandum is mailed.

SEC. 7. PREPARATION OF TECHNICAL ADVICE MEMORANDUM BY THE NATIONAL OFFICE

Analyze file

.01 Requests for technical advice generally are given priority and processed expeditiously. As soon as the request for technical advice is assigned, the technical employee analyzes the file to see whether it meets all requirements of section 3. If it does not comply with the requirements of section 3.09 relating to the statement of proposed deletions, the National Office makes the deletions from the technical advice memorandum that the Commissioner determines are required by section 6110(c) of the Code.

Branch representative informs District or Appeals Office that either:

.02 Usually, within 21 calendar days after the Branch receives the request for technical advice, a representative of the Branch telephones the District or Appeals Office to discuss the procedural and substantive issues in the request that come within the Branch's jurisdiction. The Branch representative informs the District or Appeals Office:

case being returned,

(a) that the case is being returned because substantial additional information is required to resolve an issue, because significant unresolved factual variances exist between the statement of facts submitted by the District or Appeals Office and the taxpayer, or because major procedural problems cannot be resolved by phone (a request for technical advice will not be returned or reply delayed merely because additional information not essential to the preliminary assessment of the case is needed);

additional information needed,

(b) that the case is not being returned but more information is needed or minor procedural deficiencies exist;

tentative conclusion given, or

(c) what the Branch representative's tentative conclusion is and the estimated date that the technical advice memorandum will be mailed; or

date estimated for tentative conclusion

(d) that a tentative conclusion has not been reached because of the complexity of the issue and the estimated date the tentative conclusion will be made.

Branch representative contact with District or Appeals Office

.03 Within 21 calendar days after the Branch receives the additional information requested in section 7.02(b), the Branch representative telephones the District or Appeals Office to discuss the procedural and substantive issues in the request that come within the jurisdiction of the Branch. The representative indicates either (1) the tentative conclusion and the estimated date the technical advice memorandum will be mailed, or (2) the fact that a tentative conclusion has not been reached because of the complexity of the issue and the estimated date the tentative conclusion will be made.

District or Appeals Office advised that preliminary conclusion not final

.04 The Branch representative's tentative conclusion may change during the preparation and review of the technical advice memorandum, and therefore, such conclusion should not be considered to be final and may not be communicated to the taxpayer or the taxpayer's representative. In addition, the District or Appeals Office may not tell the taxpayer what the tentative conclusion is.

Multiple issue request

.05 When the technical advice request concerns matters within the jurisdiction of more than one Branch, a representative of the Branch that received the original technical advice request informs the District or Appeals Office within the initial 21-calendar day period: (1) that the matters within the jurisdiction of another Branch have been referred to the other Branch or office for consideration, and (2) that a representative of the other Branch or office will contact the District or Appeals Office about the referral of the technical advice request within 21 calendar days after receiving it in accordance with section 7.02.

Request for additional information

.06 If during the analysis and development of the case it is determined, after discussion with the Branch Chief or reviewer, that additional information essential to the preliminary assessment of the case is needed, a Branch representative will obtain the additional information in the most expeditious manner possible from the taxpayer, the District Director, or Chief, Appeals Office. Any additional information requested from the taxpayer by the National Office must be submitted by letter appended by a penalties of perjury statement within 21 calendar days after the request for information is made.

A written request for an extension of time to submit additional material must be received by the National Office within the 21-day period, setting forth compelling facts and circumstances justifying the proposed extension. The Branch Chief, Senior Technician Reviewer, or Assistant to the Branch Chief (or Assistant Branch

Chief) of the Branch to which the case is assigned will determine whether to grant or deny the request for an extension of the 21-day period. There is no right to appeal the denial of an extension request.

If the National Office does not receive the submission within the period of 21 days, plus any extensions granted by the Branch Chief, Senior Technician Reviewer, or Assistant to the Branch Chief (or Assistant Branch Chief), the National Office will issue the technical advice memorandum based on the existing record.

Copy of additional information sent to District Director or Chief, Appeals Office

.07 Any additional information submitted by the taxpayer should be sent to the National Office and a copy sent to either the District Director or the Chief, Appeals Office, for comments on the additional information. If the District Director or Chief, Appeals Office, has comments, they must be furnished promptly to the appropriate Branch in the office of the Associate Chief Counsel (Technical).

Deleted material

.08 Generally, before replying to the request for technical advice, the National Office informs the taxpayer orally or in writing of the material likely to appear in the technical advice memorandum that the taxpayer proposed be deleted but that the Service determined should not be deleted. If so informed, the taxpayer may submit within 10 calendar days any further information, arguments, or other material that should be deleted. The Service attempts, if possible, to resolve all disagreements about proposed deletions before the National Office replies to the request for technical advice. However, the taxpayer does not have the right to a conference to resolve any disagreements about material to be deleted from the text of the technical advice memorandum. These matters, however, may be considered at any conference otherwise scheduled for the request.

Form and routing of replies

.09 Replies to requests for technical advice are addressed to the District Director or the Chief, Appeals Office. When a request for technical advice is from Appeals, the response to the appropriate Appeals Office will be routed through the National Director of Appeals, CC:AP:FS.

Two parts to replies

.10 The replies to technical advice requests are in two parts. Each part identifies the taxpayer by name, address, identification number, and year or years involved. The first part of the reply is a transmittal memorandum. In unusual cases it is a way of giving the District or Appeals Office administrative information or other information that under the nondisclosure statues, or for other reasons, may not be discussed with the taxpayer. The second part (the "technical advice memorandum") contains: (1) a statement of the issues; (2) a statement of the pertinent facts with respect to the issues; (3) a statement of the pertinent law, tax treaties, regulations, revenue rulings, and other precedents published in the Bulletin, and court decisions; (4) a discussion of the rationale developed by the National Office and (5) the conclusions of the National Office. The conclusions give direct answers, whenever possible, to the specific questions of the District or Appeals Office. The discussion of the issues is in enough detail so the District or Appeals officials know the reasoning underlying the conclusion.

Accompanying the technical advice memorandum is a notice, under section 6110(f)(1) of the Code, of intention to disclose a technical advice memorandum (including a copy of the version proposed to be open to public inspection and notations of third party communications under section 6110(d)). The District Director or the Chief, Appeals Office, forwards this notice to the taxpayer when the District Director or the Chief, Appeals Office, gives a copy of the technical advice memorandum to the taxpayer according to section 8.02.

When copy of technical advice given to taxpayer

.11 A copy of the technical advice memorandum will be given to the taxpayers only after it has been adopted by the District Director or the Chief, Appeals Office. However, in the case of technical advice memoranda described in section 6110(g)(5)(A) of the Code, relating to cases involving criminal or civil fraud investigations and jeopardy or termination assessments, a copy of the technical

advice memorandum is not given to the taxpayer until all proceedings in the investigations or assessments are completed.

Protest under section 6110 of Code

.12 After receiving the notice under section 6110(f)(1) of the Code of intention to disclose the technical advice memorandum, the taxpayer may protest the disclosure of certain information in it. The taxpayer must submit a written statement within 20 calendar days identifying those deletions not made by the Service that the taxpayer believes should have been made. The taxpayer must also submit a copy of the version of the technical advice memorandum proposed to be open to public inspection with brackets around deletions that are proposed by the taxpayer but that have not been made by the National Office. Generally, the National Office considers only the deletion of material that the taxpayer has proposed be deleted or other deletions as required under section 6110(c) of the Code before the National Office reply is sent to the District Director or the Chief, Appeals Office. Within 20 days after it receives the taxpayer's response to the notice under section 6110(f)(1), the National Office must mail the taxpayer its final administrative conclusion about the deletions to be made.

SEC. 8. ACTION ON TECHNICAL ADVICE IN DISTRICT AND APPEALS OFFICE

Processing of the case

.01 The District Director or the Chief, Appeals Office, must process the taxpayer's case on the basis of the conclusions in the technical advice memorandum unless (1) the District Director or the Chief, Appeals Office, thinks that the conclusions reached by the National Office in a technical advice memorandum should be reconsidered, or (2) the Chief, Appeals Office, in the case of technical advice unfavorable to the taxpayer, decides to settle the issue in the usual manner under existing authority.

Copy to the taxpayer

.02 The District Director or the Chief, Appeals Office, gives the taxpayer (1) a copy of the technical advice memorandum described in section 7.10, and (2) the notice under section 6110(f)(1) of the Code of intention to disclose the technical advice memorandum (including a copy of the version proposed to be open to public inspection and notations of third-party communications under section 6110(d)). This requirement does not apply to technical advice memoranda involving civil fraud or criminal investigations, jeopardy or termination assessments, as described in section 3.10, or documents to which section 6104 applies.

No copy to the taxpayer

.03 In those cases in which the National Office tells the District Director or the Chief, Appeals Office, that a copy of the technical advice memorandum should not be given to the taxpayer, the District Director or the Chief, Appeals Office, tells this to the taxpayer if the taxpayer requests a copy.

SEC. 9. EFFECT OF TECHNICAL ADVICE

Retroactive effect

.01 A taxpayer may not rely on a ruling issued to, or a technical advice memorandum received from the Service by, another taxpayer. Except in rare or unusual circumstances, a holding in a technical advice memorandum that is favorable to the taxpayer is applied retroactively. Moreover, since technical advice,

as described in section 11.04 of this revenue procedure, is issued only on closed transactions, a holding that is adverse to the taxpayer is also applied retroactively unless the Associate Chief Counsel (Technical) exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the holding.

Modification or revocation of prior technical advice

.02 A holding that modifies or revokes a holding in a prior technical advice memorandum is applied retroactively, with one exception. If the new holding is less favorable to the taxpayer than the earlier one, it generally is not applied to the period in which the taxpayer relied on the prior holding in situations involving continuing transactions.

Continuing action or series of actions—how modified or revoked

.03 If a technical advice memorandum relates to a continuing action or a series of actions, ordinarily it is applied until specifically withdrawn or until the conclusion is modified or revoked by enactment of legislation, ratification of a tax treaty, or issuance of a United States Supreme Court decision, regulations (temporary or final), a revenue ruling, or other statement published in the Internal Revenue Bulletin. Publication of a notice of proposed rulemaking does not affect the application of a technical advice memorandum.

Conditions for nonretroactivity

.04 Generally, a technical advice memorandum that revokes or modifies a letter ruling or another technical advice memorandum is not applied retroactively for either the taxpayer to whom or for whom the ruling or memorandum was originally issued or for a taxpayer whose tax liability was directly involved in such ruling or memorandum if: (1) there has been no misstatement or omission of material facts; (2) the facts at the time of the transaction are not materially different from the facts on which the ruling or memorandum was based; (3) there has been no change in the applicable law; (4) in the case of a ruling, it was originally issued on a prospective or proposed transaction; and (5) the taxpayer directly involved in the ruling or memorandum acted in good faith in relying on the ruling or memorandum and the retroactive revocation would be to the taxpayer's detriment. For example, the tax liability of each shareholder is directly involved in a ruling or memorandum on the reorganization of a corporation. However, the tax liability of members of an industry is not directly involved in a ruling or memorandum issued to one of the members, and the holding in a revocation or modification of a ruling or memorandum to one member of an industry may be retroactively applied to other members of the industry. By the same reasoning, a tax practitioner may not obtain the nonretroactive application to one client of a modification or revocation of a ruling or memorandum previously issued to another client.

When a ruling to a taxpayer or a technical advice memorandum involving a taxpayer is revoked with retroactive effect, the notice to the taxpayer, except in fraud cases, sets forth the grounds on which the revocation is being made and the reason why the revocation is being applied retroactively.

SEC. 10. PROCEDURES FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF TECHNICAL ADVICE.

Application of section 7805(b) of the Code

.01 Pursuant to section 7805(b) of the Code, it is within the discretion of the Commissioner or the Commissioner's delegate to prescribe the extent, if any, to which any ruling (including technical advice memorandum) will be applied without retroactive effect.

A taxpayer who has received a technical advice memorandum or with respect to whom a technical advice request is pending may request that the Associate Chief Counsel (Technical), the Commissioner's delegate, exercise the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of any holding stated in the technical advice memorandum or to limit the retroactive effect of any subsequent modification or revocation of the technical advice memorandum.

Form of request to limit retroactivity for a continuing transaction

.02 When a technical advice memorandum that concerns a continuing transaction is modified or revoked by, for example, a subsequent revenue ruling or final regulations, a request to limit the retroactive effect of the modification or revocation of the technical advice memorandum must be made in the form of a request for a ruling when the request is submitted before the return is examined that contains the transaction that is the subject of the request for ruling. See section 9.02 of Rev. Proc. 90-1, this Bulletin.

Form of request to limit retroactivity—during course of an examination

.03 When a taxpayer is informed of the modification or revocation of a technical advice memorandum, ruling letter, or determination letter during the course of an examination of the taxpayer's return by the District Director or during consideration by the Chief, Appeals Office, a request to limit the retroactive application of the modification or revocation of the technical advice memorandum, ruling letter, or determination letter must itself be made in the form of a request for technical advice. See section 3 of this revenue procedure. However, the taxpayer must also submit a statement, which will be forwarded to the National Office with the request for technical advice, that the request for technical advice is being made pursuant to section 7805(b) of the Code. This statement must also set forth the relief sought and an explanation of the reasons and arguments in support of the relief requested, and it must be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 9.04 of this revenue procedure as they relate to the taxpayer's particular situation. The taxpayer's request for relief pursuant to section 7805(b) must be forwarded by the District Director or the Chief, Appeals Office, to the National Office for consideration.

Form of request to limit retroactivity—technical advice that does not modify or revoke prior memorandum

.04 A request to limit the retroactive effect of a holding in a technical advice memorandum that does not modify or revoke a technical advice memorandum may be made as part of that technical advice request, either initially, or at any time before the technical advice memorandum is issued by the National Office. In such a case, the taxpayer must also submit a statement in support of the application of section 7805(b) of the Code, as described in .03 above.

Taxpayer's right to a conference

.05 When a request for technical advice concerns only the application of section 7805(b) of the Code, the taxpayer has the right to a conference in the National Office in accordance with the provisions of section 6 of this revenue procedure. If the request for application of section 7805(b) is included in the request for technical advice on the substantive issues or is made before the conference of right on the substantive issues, the section 7805(b) issues will be discussed at the taxpayer's one conference of right. If the request for the application of section 7805(b) is made as part of a pending technical advice request after a conference has been held on the substantive issue, and the Service determines that there is justification for having delayed the request, then the taxpayer will have the right to one conference of right concerning the application of section 7805(b) with the conference limited to discussion of this issue.

SEC. 11. DEFINITIONS AND NATURE OF TECHNICAL ADVICE

Taxpayer

.01 For purposes of this revenue procedure, the word "taxpayer" includes all persons subject to any provision of the Internal Revenue Code and, when appropriate, their representatives and issuers of section 103 obligations.

National Office

.02 Any reference to the National Office means only the Office of the Associate Chief Counsel (Technical).

District Director

.03 Any reference to District Director or District Office includes the office of the Director of the Foreign Operations District, where appropriate. Any reference to Chief, Appeals Office, includes Associate Chief, Appeals Office.

Technical Advice

.04 "Technical advice" means advice or guidance furnished by the National Office upon requests of a District or an Appeals Office in response to any technical or procedural question that develops during any stage of any proceeding on the interpretation and proper application of tax law, tax treaties, regulations, revenue rulings, or other precedents published by the National Office to a specific set of facts. Such proceedings include (1) the examination of a taxpayer's return, (2) consideration of a taxpayer's claim for refund or credit, or (3) any other matter involving a specific taxpayer under the jurisdiction of the Chief, Examination Division, such as the consideration of a taxpayer's application to enter into an agreement about the useful life method, and rate of depreciation of business property provided by section 167(d) of the Code. These proceedings include an examination to determine whether obligations issued are described in section 103(a). They also include processing and considering nondocketed cases in an Appeals Office. However, they do not include cases in which the issue in the case is in a docketed case for that year or for any prior or subsequent year.

Technical advice is furnished as a way of helping Service personnel close cases and establish and maintain consistent holdings throughout the Internal Revenue Service. A District Director or an Appeals Office may raise an issue in any tax period, even though technical advice may have been asked for and furnished for the same or a similar issue for another tax period. Technical advice does not include memoranda on matters of general technical application furnished to District or Appeals Offices when the issues are not raised in connection with a proceeding involving a specific taxpayer.

Section 521 of the Code

.05 If a District Director, Chief, Appeals Office, or a taxpayer requests technical advice on a determination letter under section 521 of the Code, the procedures under Rev. Proc. 80-26, 1980-1 C.B. 671, and Rev. Proc. 84-46, 1984-1 C.B. 541, as modified by Rev. Proc. 85-32, 1985-2 C.B. 414, as well as section 601.201(n) of the Statement of Procedural Rules, must be followed.

Revocation of ruling letter

.06 Only the National Office can revoke a ruling letter. Therefore, if a District Director or a Chief, Appeals Office, thinks that a ruling letter previously issued to a taxpayer should be modified or revoked, including a ruling that involves a matter that is the subject of or is otherwise closely related to a criminal or civil fraud investigation or a jeopardy or termination assessment, the procedures in section 3 of this revenue procedure must be followed.

When technical advice can be requested

.07 The provisions of this revenue procedure apply only to a case under the jurisdiction of a District Director or Chief, Appeals Office. Technical advice may be requested on issues considered in a prior Appeals disposition, not based on mutual concessions for the same tax period of the same taxpayer, if the Appeals Office that had the case concurs in the request. A District Director may not request technical advice on an issue if an Appeals Office is currently considering an identical issue of the same taxpayer (or of a related taxpayer within the meaning of section 267 of the Code or a member of an affiliated group of which the taxpayer is also a member within the meaning of section 1504). A case remains under the jurisdiction of the District Director even though an Appeals Office has the identical issue under consideration in the case of another taxpayer (not related within the meaning of section 267 or 1504) in an entirely different transaction. With respect to the same taxpayer or the same transaction, when the issue is under the jurisdiction of an Appeals Office, and the applicability of more than one kind of tax is dependent upon the resolution of that issue, a District Director may not request technical advice on the applicability of any of the taxes involved.

SEC. 12. CHANGES

.01 Page numbers have been assigned to the principal headings of the table of contents and the format of the text and the sequence of the sections of Rev. Proc. 89-2 have been changed in an effort to make this document (Rev. Proc. 90-2) easier to read and apply.

.02 A new section 4.05 is added to permit taxpayers to appeal a denial of a request for technical advice in situations in which the authority normally exercised by the District Director or Chief, Appeals Office, has been delegated to another official.

.03 Section 11.04 is clarified to indicate that technical advice may not be requested if the issue in the case is in a docketed case.

SEC. 13. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 89-2 is superseded.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 90-3

SECTION 1. PURPOSE AND NATURE OF CHANGES

.01 The purpose of this revenue procedure is to update Rev. Proc. 89-3, 1989-1 C.B. 761, as amplified and modified by subsequent revenue procedures, by providing a revised list of those areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Technical) relating to issues in which the Internal Revenue Service will not issue advance rulings or determination letters. For a list of areas under the jurisdiction of the Associate Chief Counsel (International) relating to international is-sues in which the Service will not issue advance rulings or determination letters, see Rev. Proc. 90-6, page 430, this Bulletin. When applicable, the Technical and Miscellaneous Revenue Act of 1988 will be referred to as "TAMRA," the Tax Reform Act of 1986 will be referred to as "TRA 1986," the Tax Reform Act of 1984, will be referred to as "TRA 1984," and the Tax Equity and Fiscal Responsibility Act of 1982 will be referred to as "TEFRA."

.02 Changes

1. Old section 3.017 has been modified to reflect the repeal of section 162(k)(3)(B) of the Code by TAMRA.

2. Old Section 3.0114 has been modified. See Rev. Proc. 89-67, 1989-2 C.B. 795.

3. New section 3.0121 refers to section 355 of the Code. See Rev. Proc. 89-39, 1989-1 C.B. 922.

4. Old sections 3.0136, 3.0137, and 3.0138 have been deleted. See Rev. Proc. 89-12, 1989-1 C.B 798.

6. New section 4.016 refers to section 103 of the Code. See Rev. Proc. 89-5, 1989-1 C.B. 774.

7. New sections 4.0115, 4.0128, and 4.0133 refer to sections 170, 664, and 2522 of the Code respectively. See Rev. Proc. 89-19, 1989-1 C.B. 841.

8. Old sections 5.04, 5.10, 5.11, 5.12, 5.18, 5.19, 5.20, 5.21, 5.22, and 5.23 have been deleted. See Rev. Proc. 89-36, 1989-1 C.B. 919.

9. New section 5.04 refers to sections 83 and 451 of the Code. See Rev. Proc. 89-22, 1989-1 C.B. 843.

10. Old section 5.06 has been modified to delete sections 501(c)(9) and (c)(17) of the Code to reflect the addition of section 419 by TRA 1984.

11. New section 5.06 refers to section 107 of the Code. See Rev. Proc. 89-54, 1989-2 C.B. 633.

12. New section 5.16 refers to section 1031(a)(1) of the Code. See Rev. Proc. 89-63, 1989-2 C.B. 783.

13. New section 5.20 refers to sections 3121 and 3306 of the Code. See Rev. Proc. 89-7, 1989-1 C.B. 778.

14. Old section 5.27 has been deleted. See Rev. Proc. 89-26, 1989-1 C.B. 892.

SEC. 2. BACKGROUND AND SCOPE OF APPLICATION

.01 Background.

Whenever appropriate in the interest of sound tax administration, it is the policy of the Service to answer inquiries of individuals and organizations regarding their status for tax purposes and the tax effects of their acts or transactions, prior to the filing of returns or reports that are required by the revenue laws.

There are, however, certain areas in which, because of the inherently factual nature of the problems involved, or for other reasons, the Service will not issue advance rulings or determination letters. These areas are set forth in three sections of this revenue procedure. Section 3 reflects those areas in which advance rulings and determinations will not be issued. Section 4 sets forth those areas in which they will not ordinarily be issued. "Not ordinarily" connotes that unique and compelling reasons must be demonstrated to justify the issuance of a ruling or determination letter. Those sections reflect a number of specific questions and problems as well as general areas. Section 5 lists specific areas for which the Service is temporarily not issuing advance rulings and determinations because those matters are under extensive study. See Rev. Proc. 90-1, page 356, this Bulletin, particularly section 18 captioned "Discretionary Authority to Issue Rulings and Determination Letters" for general instructions and other situations in which the Service will not or ordinarily will not issue rulings or determination letters.

With respect to the items listed, revenue rulings or revenue procedures may be published in the Internal Revenue Bulletin from time to time to provide general guidelines regarding the position of the Service.

Additions or deletions to this revenue procedure as well as restatement of items listed will be made by modification of this revenue procedure. Changes will be published as they occur throughout the year and will be incorporated annually in a new revenue procedure published as the third revenue procedure of the year. These lists should not be considered all-inclusive. Decisions not to rule on individual cases, as contrasted with those that present significant pattern issues, are not reported in this revenue procedure and will not be added to subsequent revisions.

.02 Scope of Application.

This revenue procedure is not to be considered as precluding the submission of requests for technical advice to the National Office from the Office of a District Director of the Internal Revenue or a Chief, Appeals Office.

SEC. 3. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED

.01 Specific questions and problems.

1. Section 79.—Group-Term Life Insurance Purchased for Employees .—Whether a group insurance plan for 10 or more employees qualifies as group-term insurance if the amount of insurance is not computed under a formula that would meet the requirements of section 1.79-1(c)-(2)(ii) of the Income Tax Regulations if the group consisted of fewer than 10 employees.

2. Section 83.—Property Transferred in Connection with Performance of Services.—Whether a restriction constitutes a substantial risk of forfeiture if the employee is a controlling shareholder. Also, whether a transfer has occurred if the amount of the property involves a nonrecourse obligation.

3.(a) Section 105(h).—Amount Paid to Highly Compensated Individuals under Discriminatory Self-Insurance Medical Expense Reimbursement Plan.—Whether, following a determination that a self-insured medical expense reimbursement plan is discriminatory, that plan had previously made reasonable efforts to comply with tax discrimination rules.

(b) Section 117.—Scholarships and Fellowship Grants.—Whether an employer-related scholarship or fellowship grant is excludible from the employee's gross income if there is no intermediary private foundation distributing the grants, as there was in Rev. Proc. 76-47, 1976-2 C.B. 670.

4. Section 119.—Meals or Lodging Furnished for the Convenience of the Employer.—Whether the value of meals or lodging is excludible from gross income by an employee who is a controlling shareholder of the employer.

5. Sections 121 and 1034.—One-Time Exclusion of Gain from Sale of Principal Residence by an Individual Who Has Attained Age 55; Rollover of Gain on Sale of Principal Residence.—Whether property qualifies as the taxpayer's principal residence.

6. Section 162.—Trade or Business Expenses.—Whether compensation is reasonable in amount.

7. Section 163.—Interest.—The income tax consequences of transactions involving "shared appreciation mortgage" (SAM) loans in which a taxpayer, borrowing money to purchase real property, pays a fixed rate of interest on the mortgage loan below the prevailing market rate and will also pay the lender a percentage of the appreciation in value of the real property upon termination of the mortgage. This applies to all SAM arrangements where the loan proceeds are used for commercial or business activities, or where used to finance a personal residence if the facts are not similar to those described in Rev. Rul. 83-51, 1983-1 C.B. 48. (Also sections 61, 451, 461, 856, 1001, and 7701 of the Code).

8. Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who advances funds to a charitable organization and receives therefor a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsement on the note.

9. Section 213(a).—Medical, Dental, Etc., Expenses.—Whether a capital expenditure for an item that is ordinarily used for personal, living, or family purposes, such as a swimming pool, has as its primary purpose the medical care of the taxpayer or the taxpayer's spouse or dependent, or is related directly to such medical care.

10. Section 264(b).—Certain Amounts Paid in Connection with Insurance Contracts.—Whether "substantially all" the premiums of a contract of insurance are paid within a period of 4 years from the date on which the contract is purchased. Also, whether an amount deposited is in payment of a "substantial number" of future premiums on such a contract.

11. Section 264(c)(1).—Certain Amounts Paid in Connection with Insurance Contracts.—Whether section 264(c)(1) of the Code applies.

12. Section 269.—Acquisitions Made to Evade or Avoid Income Tax.—Whether an acquisition is with-

in the meaning of section 269 of the Code.

13. Section 274.—Disallowance of Certain Entertainment, Etc., Expenses.—Whether a taxpayer who is traveling away from home on business may, in lieu of substantiating the actual cost of meals, deduct a fixed per-day amount for meal expenses that differs from the amount prescribed in Rev. Proc. 89-67, 1989-2 C.B. 795.

14. Section 302.—Distributions in Redemption of Stock.—Whether section 302(b) of the Code applies when the consideration given in redemption by a corporation consists entirely or partly of its notes payable, and the shareholder's stock is held in escrow or as security for payment of the notes with the possibility that the stock may or will be returned to the shareholder in the future, upon the happening of specific defaults by the corporation.

15. Section 302.—Distributions in Redemption of Stock.—Whether section 302(b) of the Code applies when the consideration given in redemption by a corporation in exchange for a shareholder's stock consists entirely or partly of the corporation's promise to pay an amount based on, or contingent on, future earnings of the corporation, when the promise to pay is contingent on working capital being maintained at a certain level, or any other similar contingency.

16. Section 302.—Distributions in Redemption of Stock.—Whether section 302(b) of the Code applies to a redemption of stock if after the redemption the distributing corporation uses property that is owned by the shareholder from whom the stock is redeemed and the payments by the corporation for the use of the property are dependent upon the corporation's general creditors. Payments for the use of property will not be considered to be dependent upon future earnings merely because they are based on a fixed percentage of receipts or sales.

17. Section 302.—Distributions in Redemption of Stock.—Whether the acquisition or disposition of stock described in section 302(c)(2)(B) of the Code has, or did not have, as one of its principal purposes the avoidance of federal income taxes within the meaning of that section, unless the facts and circumstances are materially identical to those set forth in Rev. Rul. 56-556, 1956-2 C.B. 177, Rev. Rul. 56-584, 1956-2 C.B. 179, Rev. Rul. 57-387, 1957-2 C.B. 225, Rev. Rul. 77-293, 1977-2 C.B. 91, Rev. Rul. 79-67, 1979-1 C.B. 128, or Rev. Rul. 85-19, 1985-1 C.B. 94.

18. Section 302(b)(4) and (e) (pre-TEFRA section 346(a)(2) and (b)).—Partial Liquidation.—The amount of working capital attributable to a business or portion of a business terminated that may be distributed in partial liquidation.

19. Sections 311 and 336 (pre-TRA 1986).—Taxability of Corporation on Distribution; General Rule.—Upon distribution of property in kind by a corporation to its shareholders, in complete liquidation under section 331 of the Code (when under the facts a sale of the property by the corporation would not qualify under pre-TRA 1986 section 337) and section 346(a) (pre-TEFRA section 346(a)(1)), in partial liquidation under section 302(b)(4) and (e) (pre-TEFRA section 346(a)(2) and (b)) or in redemption of stock under section 302(a), followed by a sale of the property, whether the sale can be deemed to have been made by the corporation under the doctrine of *Commissioner v. Court Holding Company*, 324 U.S. 331 (1945), 1945 C.B. 58.

20. Section 312.—Effect on Earnings and Profits.—The determination of the amount of earnings and profits of a corporation.

21. Section 355.—Distribution of Stock and Securities of a Controlled Corporation.—The determination of whether the corporate business requirement of section 1.355-2(b) of the regulations is satisfied in the following situations:

(1) Whether the reduction of nonfederal taxes is substantially coextensive with the reduction of federal taxes.

(2) If a transaction has the potential of avoiding federal taxes but has another corporate business purpose, whether the non-avoidance purpose is the "substantial" motivation for the transaction.

(3) If a transaction has the potential of avoiding federal taxes but the stated purpose is to reduce foreign taxes.

22. Section 368(a)(1)(B).—Definitions Relating to Corporate Reorganizations.—The acceptability of an estimation procedure or the acceptability of a specific sampling procedure to determine the basis of stock acquired by an acquiring corporation in a reorganization described in section 368(a)(1)(B) of the Code.

23. Section 368(a)(1)(E).—Definitions Relating to Corporate Reorganizations.—Whether a transaction constitutes a corporate recapitalization within the meaning of section 368(a)(1)(E) of the Code (or a transaction that also qualified under section 1036) when either (1) the transaction involves a closely-held corporation or (2) the issues involved are substantially similar to those described in the following revenue rulings:

Rev. Rul. 82-34, 1982-1 C.B. 59 (continuity of business enterprise);

Rev. Rul. 77-479, 1977-2 C.B. 119 (continuity of shareholder interest);

Rev. Rul. 77-238, 1977-2 C.B. 115 (conversion of shares of one class of stock into shares of another class, as permitted by certificate of incorporation);

Rev. Rul. 74-269, 1974-1 C.B. 87 (major shareholder's exchange of common stock for preferred stock);

Rev. Rul. 56-654, 1956-2 C.B. 216 (corporate charter amended to provide preferred stock with increased redemption and liquidation value, where common and preferred stock held pro rata);

Rev. Rul. 55-112, 1955-1 C.B. 344 (common stock exchanged for preferred stock); and

Rev. Rul. 54-482, 1954-2 C.B. 148 (old common stock exchanged for new common stock). The above no-ruling area does not apply, however, to any corporate recapitalization that is an integral part of a larger transaction if it is impossible to determine the tax consequences of the larger transaction without making a determination with regard to the recapitalization.

24. Section 451.—General rule for Taxable Year of Inclusion.—The tax consequences of a non-qualified unfunded deferred compensation arrangement with respect to a controlling shareholder employee eligible to participate in the arrangement.

25. Sections 451 and 457.—General Rule for Taxable Year of Inclusion; Deferred Compensation Plans with Respect to Service for State and Lo-

cal Governments.—The tax consequences to unidentified independent contractors in nonqualified unfunded deferred compensation plans. This applies to plans established under section 451 of the Code by employers in the private sector and to eligible state plans under section 457. However, a ruling with respect to a specific independent contractor's participation in such a plan may be issued.

26. Section 641.—Imposition of Tax.—Whether the period of administration or settlement of an estate is reasonable or unduly prolonged.

27. Section 642(c).—Deduction for Amounts Paid or Permanently Set Aside for a Charitable Purpose.—Allowance of an unlimited deduction for amounts set aside by a trust or estate for charitable purposes when there is a possibility that the corpus of the trust or estate may be invaded.

28. Section 704(e).—Family Partnerships.—Matters relating to the validity of a family partnership when capital is not a material income producing factor.

29. Section 856.—Definition of a Real Estate Investment Trust.—Whether a corporation whose stock is "paired" with or "stapled" to stock of another corporation will qualify as a real estate investment trust under section 856 of the Code if the activities of the corporations are integrated.

30. Section 1221.—Capital Asset Defined.—Whether specialty stock allocated to an investment account by a registered specialist on a national securities exchange is a capital asset.

31. Section 1551.—Disallowance of Surtax Exemption and Accumulated Earnings Credit.—Whether a transfer is within section 1551 of the Code.

32. Section 2031.—Definition of Gross Estate.—Actuarial factors for valuing interests in the prospective gross estate of a living person.

33. Section 2512.—Valuation of Gifts.—Actuarial factors for valuing prospective or hypothetical gifts of a donor.

34. Section 7701.—Definitions.—Whether a foreign arrangement that is a participant in a domestic arrangement classified as a partnership for U.S. tax purposes will itself be classified as a partnership.

35. Section 7701.—Definitions.—Whether a foreign limited liability company will be classified as a partnership if the taxpayer requests classification as a partnership and (1) the taxpayer is a corporation and less than 20 percent of the interests in the limited liability company are held by independent parties or (2) the taxpayer is not a corporation and independent parties hold only a nominal interest in the company.

.02 General Areas.

1. The results of transactions that lack a bona fide business purpose or have as their principal purpose the reduction of federal taxes.

2. A matter upon which a court decision adverse to the government has been handed down and the question of following the decision or litigating further has not yet been resolved.

3. A matter involving alternate plans of proposed transactions or involving hypothetical situations.

4. A matter involving the federal tax consequences of any proposed federal, state, local or municipal legislation. The Service may provide general information in response to an inquiry.

5. Whether under Subtitle F (Procedure and Administration) of the Code reasonable cause, due diligence, good faith, clear and convincing evidence, or other similar terms that require a factual determination exist.

6. Whether a proposed transaction would subject the taxpayer to a criminal penalty.

7. A request that does not comply with the provisions of Rev. Proc. 90-1.

8. Whether, under the common law rules applicable in determining the employer-employee relationship, a professional staffing corporation (loan-out corporation) or the subscriber is the employer of individuals if:

(1) the loan-out corporation hires employees of the subscriber and assigns the employees back to the subscriber, or

(2) the loan-out corporation assigns individuals to subscribers for more than a temporary period (1 year or longer).

SEC. 4. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT ORDINARILY BE ISSUED

.01 Specific questions and problems.

1. Sections 38, 39, 46, and 48.—Investment Tax Credit.—Application of these sections where the formal ownership of property is in a party other than the taxpayer, except when title is held merely as security.

2. Section 61.—Gross Income Defined.—Determination as to who is the true owner of property in cases involving the sale of securities, or participation interests therein, where the purchaser has the contractual right to cause the securities, or participation interests therein, to be purchased by either the seller or a third party.

3. Sections 61 and 163.—Gross Income Defined; Interest.—Determinations as to who is the true owner of property or the true borrower of money in cases in which the formal ownership of the property or liability for the indebtedness is in another party.

4. Section 103.—Interest on State and Local Bonds.—Whether the interest on state and local bonds will be excludible from gross income under section 103(a) of the Code if the proceeds of issues of bonds (other than advance refunding issues) are placed in escrow or otherwise not expended for a governmental purpose for an extended period of time even though the proceeds are invested at a yield that will not exceed the yield on the state and local bonds prior to their expenditure.

5. Section 103.—Interest on Certain Governmental Obligations.—Whether an issue of industrial development bonds is exempt under section 103(b) of the Code when 10 percent or more of the proceeds of the issue (minus "neutral costs," as described in Rev. Rul. 80-171, 1980-2 C.B. 44) are used to finance a facility in which an owner (or a related person) or a lessee (or a related person), who was a user of the facility before the bonds were issued, will be a user of the facility after the bonds are issued.

6. Section 103.—Interest on Certain Governmental Obligations.—Whether a state or local governmental obligation that does not meet the criteria of section 5 of Rev. Proc. 89-5 is an "arbitrage bond" within the meaning of former section 103(c)(2) of the Code solely by reason of the investment of the bond proceeds in acquired nonpurpose obligations at a materially higher yield more than 3

years after issuance of the bonds or 5 years after issuance of the bonds in the case of construction issues described in section 1.103-13(a)(2)(ii)(E) of the regulations.

7. Section 141.—Private Activity Bond; Qualified Bond.—With respect to requests made pursuant to Rev. Proc. 88-33, 1988-1 C.B. 835, whether state or local bonds will meet the "private business use tests" and the "private security or payment test" under section 141(b)(1) and (2) of the Code in situations in which the proceeds are used to finance certain output facilities and, pursuant to a contract to take, or take or pay for, a nongovernmental person purchases 30 percent or more of the actual output of the facility but 10 percent or less of the subparagraph (5) output of the facility as defined in section 1.103-7(b)(5)(ii)(b) of the regulations (issued under former section 103(b) of the Code). In similar situations, the Service will not ordinarily issue rulings or determination letters concerning questions arising under paragraphs (3), (4), and (5) of section 141(b).

8. Section 148.—Arbitrage.—Whether amounts received as proceeds from the sale of municipal bond financed property and pledged to the payment of debt service or pledged as collateral for the municipal bond issue are sinking fund proceeds within the meaning of section 1.103-13(g) of the regulations (issued under former section 103(c) of the Code) or replaced proceeds described in section 148(a)(2) (or former section 103(c)(2)(B)).

9. Section 162.—Trade or Business Expenses.—Whether the requisite risk shifting and risk distribution necessary to constitute insurance are present for purposes of determining the deductibility under section 162 of the Code of amounts paid (premiums) by a taxpayer for insurance, unless the facts of the transaction are within the scope of Rev. Rul. 77-316, 1977-2 C.B. 53, or Rev. Rul. 78-338, 1978-2 C.B. 107.

10. Sections 162 and 262.—Commuting Expenses.—Whether expenses are nondeductible commuting expenses.

11. Section 167.—Depreciation.

(1) Useful lives of assets.

(2) Depreciation rates.

(3) Salvage value of assets.

12. Sections 167 and 168.—Depreciation; Accelerated Cost Recovery System.—Application of those sections where the formal ownership of property is in a party other than the taxpayer except when title is held merely as security.

13. Section 170.—Charitable, Etc., Contributions and Gifts.—Whether transfer to a pooled income fund described in section 642(c)(5) of the Code qualifies for a charitable contribution deduction under section 170(f)(2)(A).

14. Section 170(c).—Charitable, Etc., Contributions and Gifts.—Whether a taxpayer who transfers property to a charitable organization and thereafter leases back all or a portion of the transferred property may deduct the fair market value of the property transferred and leased back as a charitable contribution.

15. Section 170.—Charitable, Etc., Contributions and Gifts.—Whether a transfer to an inter vivos charitable remainder trust described in section 664 of the Code that provides for annuity or unitrust payments for one measuring life qualifies for a charitable contribution deduction under section 170(f)(2)(A).

16. Section 216.—Deduction of Taxes, Interest, and Business Depreciation by Cooperative Housing Corporation Tenant Stockholder.—If a cooperative housing corporation (CHC), as defined in section 216(b)(1) of the Code, transfers an interest in real property to a corporation (not a CHC) in exchange for stock or securities of the transferee corporation, which engages in commercial activity with respect to the real property interest transferred, whether (1) the income of the transferee corporation derived from the commercial activity, and (2) any cash or property (attributable to the real property interest transferred) distributed by the transferee corporation to the CHC will be considered as gross income of the CHC for the purpose of determining whether 80 percent or more of the gross income of the CHC is derived from tenant-stockholders within the meaning of section 216(b)(1)(D).

17. Section 301.—Distribution in Redemption of Stock.—The tax effect of the redemption of stock for notes, when the payments on the notes are to be made over a period in excess of 15 years from the date of issuance of such notes.

18. Section 302(b)(4) and (e) (pre-TEFRA section 346(a)(2)).—Partial Liquidation.—Whether a distribution will qualify as a distribution in partial liquidation under section 302(b)(4) and (e)(1)(A) (pre-TEFRA section 346(a)(2)) of the Code, unless it results in a 20 percent or greater reduction in (1) gross revenue, (2) net fair market value of assets, and (3) employees.

19. Sections 302(b)(4) and (e) (pre-TEFRA section 346(a)(2) and (b)), 331, 332, pre-TRA 1986 section 333 and section 346(a) (pre-TEFRA section 346(a)(1)).—Effects on Recipients of Distributions in Corporate Liquidations.—The tax effect of the liquidation of a corporation preceded or followed by the reincorporation of all or a part of the business and assets when more than a nominal amount of the stock (that is, more than 20 percent in value) of both the liquidating corporation and the transferee corporation is owned by the same shareholder; or when a liquidation is followed by the sales of the corporate assets by the shareholders to another corporation in which such shareholders own more than a nominal amount of the stock (that is, more than 20 percent in value).

20. Section 306.—Disposition of Certain Stock.—Whether the distribution or disposition or redemption of "section 306 stock" in a closely held corporation is in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes within the meaning of section 306(b)(4) of the Code.

21. Sections 331 and 346(a).—Gain or Loss to Shareholders in Corporate Liquidations.—The tax effect of the liquidation of a corporation by a series of distributions, when the distributions in liquidation are to be made over a period in excess of 3 years from the adoption of the plan of liquidation.

22. Section 336 (pre-TRA section 337).—Gain or Loss; Certain Liquidations.—The application of this section to a corporation upon the sale of property, in connection with its liquidation, to another corporation, when more than a nominal amount of the stock (that is, more than 20 percent in value) of both the selling corpora-

tion and the purchasing corporation is owned by the same persons.

23. Section 341.—Collapsible Corporations.—Whether a corporation will be considered to be a "collapsible corporation," that is, whether it was "formed or availed of" with the view of certain tax consequences. However, ruling requests will be considered on this matter when the enterprise (1) has been in existence for a least 20 years or has clearly demonstrated that it has realized two-thirds of the taxable income to be derived from the manufacturing, constructing, producing, or purchasing of property as stated in section 341(b)(1)(A) of the Code and as described in Rev. Rul. 72-48, 1972-1 C.B. 102; (2) has had an aggregate change in the shareholders' interests of not more than 10 percent during that period (except for transfers among family members, as defined in section 267(c)(4), or redemptions of stock to pay death taxes pursuant to section 303); and (3) has conducted substantially the same trade or business during that period. The period referred to in (2) and (3) above is the lesser of 20 years of corporate existence or the period in which the enterprise has realized two-thirds of the taxable income from activities specified in section 341(b)(1)(A).

24. Section 351.—Transfers to a Controlled Corporation.—The tax effect of the transfer when part of the consideration received by the transferors consists of an instrument that is a bond, debenture, or any other evidence of indebtedness of the transferee and either (1) the terms of the instrument permit, at the option of the issuer or holder, the payment of all or part of the principal on the instrument in less than 10 years from its issuance, or (2) a determination as to whether the "indebtedness" is properly classified as debt or equity is required in order to establish that the requirements of section 351 of the Code are met.

25. Section 351.—Transfer to Corporation Controlled by Transferor.—Whether section 351 of the Code applies to the transfer of an interest in real property by a cooperative housing corporation (as described in section 216(b)(1)) to a corporation in exchange for stock or securities of the transferee corporation if the transferee engages in commercial activity with respect to the real property interest transferred.

26. Section 355.—Distribution of Stock and Securities of a Controlled Corporation.—Whether the active business requirement of section 355(b) of the Code is met when, within the 5-year period described in section 355(b)(2)(B), a distributing corporation acquired control of a controlled corporation as a result of the distributing corporation transferring cash or other liquid or inactive assets to the controlled corporation in a transaction in which gain or loss was not recognized as a result of the transfer meeting the requirements of section 351(a) or 368(a)(1)(D).

27. Section 642.—Pooled Income Funds.—Whether a pooled income fund satisfies the requirements described in section 642(c)(5) of the Code.

28. Section 664.—Charitable Remainder Trusts.—Whether an inter vivos charitable remainder annuity trust or unitrust that provides for annuity or unitrust payments for one measuring life satisfies the requirements described in section 664 of the Code.

29. Section 816.—Definition of Life Insurance Company.—Whether the requisite risk shifting and risk distribution necessary to constitute insurance are present for purposes of determining if a company is an "insurance company" under section 1.801-3(a) of the regulations, unless the facts of the transaction are within the scope of Rev. Rul. 77-316, 1977-2 C.B. 53, or Rev. Rul. 78-338, 1978-2 C.B. 107.

30. Section 1502.—Regulations.—Whether a parent cooperative housing corporation (as defined in section 216(b)(1) of the Code) will be permitted to file a consolidated income tax return with its transferee subsidiary if the transferee engages in commercial activity with respect to the real property interest transferred to it by the parent.

31. Section 2055.—Transfers for Public, Charitable and Religious Uses.—Whether a transfer to a pooled income fund described in section 642(c)(5) of the Code qualifies for a charitable deduction under section 2055(e)(2)(A).

32. Section 2522.—Charitable and Similar Gifts.—Whether a transfer to a pooled income fund described in section 642(c)(5) of the Code qualifies for a charitable deduction under section 2522(c)(2)(A).

33. Section 2522.—Charitable and Similar Gifts.—Whether a transfer to an inter vivos charitable remainder trust described in section 664 of the Code that provides for annuity or unitrust payments for one measuring life qualifies for a charitable deduction under section 2522(c)(2)(A).

34. Section 7701.—Definitions.—Whether what is generally known as a foreign corporation will be classified as a partnership for U.S. tax purposes if the taxpayer requests classification as a partnership.

35. Section 7701.—Definitions.—Whether a foreign partnership will be classified as an association for U.S. tax purposes if the taxpayer requests classification as an association.

.02 General areas.

1. Any matter in which the determination requested is primarily one of fact, e.g., market value of property, or whether an interest in a corporation is to be treated as stock or indebtedness.

2. The tax effect of any transaction to be consummated at some indefinite future time.

3. Any matter dealing with the question of whether property is held primarily for sale to customers in the ordinary course of a trade or business.

4. The tax effect of a transaction if any part of the transaction is involved in litigation among the parties affected by the transaction, except for transactions involving bankruptcy reorganizations.

SEC. 5. AREAS UNDER EXTENSIVE STUDY IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED UNTIL THE SERVICE RESOLVES THE ISSUE THROUGH PUBLICATION OF A REVENUE RULING, REVENUE PROCEDURE, REGULATIONS OR OTHERWISE

.01 Section 61.—Gross Income Defined.—Whether amounts voluntarily deferred by a taxpayer under a deferred compensation plan maintained by an organization described in section 501 of the Code are currently includible in the taxpayer's gross income.

.02 Sections 61 and 162.—Gross Income Defined; Trade or Business Expenses.—The tax consequences with respect to a salary reduction arrangement under which an employee receives and returns salary amounts to the employer. (Also sections 3121, 3306, and 3401 of the Code).

.03 Section 79.—Group-Term Life Insurance Purchased for Employees .—Whether life insurance provided for employees under a "retired lives reserve" plan will be considered group-term insurance, (Also sections 61, 72, 83, 101, 162, 264, and 641 of the Code).

.04 Sections 83 and 451.—Property Transferred in Connection with Performance of Services; General Rule for Taxable Year of Inclusion.—When compensation is realized by a person who, in connection with the performance of services, is granted a nonstatutory option without a readily ascertainable fair market value to purchase stock at a price that is less than the fair market value of the stock on the date the option is granted.

.05 Section 105.—Amounts Received Under Accident and Health Plans.—Whether a medical reimbursement plan, funded by employer contributions, containing a provision allowing unused amounts to be carried over and accumulated in an employee's account qualifies as an accident and health plan under section 105 of the Code.

.06 Section 107.—Rental value of parsonages.—Whether amounts distributed to a retired minister from a pension or annuity plan should be excludible from the minister's gross income as a parsonage allowance under section 107 of the Code.

.07 Section 162.—Trade on Business Expenses.—Whether payments paid or accrued by a corporation to an exempt organization as described in section 501(c)(7) or (c)(20) of the Code are deductible under section 162.

.08 Section 302(b)(4) and (e) (also pre-TEFRA section 346(a)(2) and (b)).—Partial Liquidation.—Whether the absence of an actual redemption of stock is a meaningless gesture within the meaning of Rev. Rul. 79-257, 1979-2 C.B. 136, as amplified by Rev. Rul. 81-3, 1981-1 C.B. 125, when:

(1) The corporation has outstanding more than one class of stock and there are priorities as to dividend or liquidating distributions or any other differences in stock rights, or

(2) Either under the terms of the stock or as established contractually, there are outstanding any rights affecting the corporation's stock, such as, but not limited to, warrants, options, convertible securities, shareholder agreements, or rights of first refusal.

.09 Section 306(b)(4).—Transactions Not in Avoidance.—Whether section 306(b)(4) of the Code applies to the distribution and disposition or redemption of "section 306 stock" that is subject to mandatory redemption.

.10 Section 331 (pre-TRA 1986 section 337), and sections 453 and 1239. —The Tax Effects of Installment Sales of Property Between Entities with Common Ownership.—The tax effects of a transaction in which there is a transfer of property by a corporation to a partnership or other noncorporation entity (or the transfer of stock to such entity followed by a liquidation of the corporation) when more than a nominal amount of the stock of such corporation and the capital or beneficial interests in the purchasing entity (that is, more than 20 percent in value) is owned by the same persons, and the consideration to be received by the selling corporation or the selling shareholders includes an installment obligation of the purchasing entity.

.11 Section 351.—Transfer to Corporation Controlled by Transferor.—Whether section 351 of the Code applies to the transfer of widely held developed or undeveloped real property or interests therein; widely held oil and gas properties or interests therein; or any similarly held properties or interests to a corporation in exchange for shares of stock of such corporation when (1) the transfer is the result of solicitation by promoters, brokers, or investment houses, or (2) the transferee corporation's stock is issued in a form designed to render it readily tradable.

.12 Section 368.—Definitions Relating to Corporate Reorganizations.—Whether a transaction qualifies under either section 368(a)(1)(B) or section 351(a) of the Code by reason of Rev. Rul. 67-448, 1967-2 C.B. 144, when the same transaction is structured under section 368(a)(1)(A) and 368(a)(2)(E) (as a reverse triangular merger) and fails to qualify for an advance ruling under those sections merely because the "substantially all" requirement set forth in section 3.01 of Rev. Proc. 77-37, 1977-2 C.B. 568, as amplified by Rev. Proc. 86-42, 1986-2 C.B. 722, is not met.

.13 Section 422A.—Incentive Stock Options.—Whether Holding (1) of Rev. Rul. 80-244, 1980-2 C.B. 234, relating to section 1036 of the Code, applies to incentive stock options.

.14 Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners.—Whether the grantor will be considered the owner of any portion of a trust when (1) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (2) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (3) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, and (4) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under sections 673 to 677 of the Code.

.15 Section 721.—Nonrecognition of Gain or Loss on Contribution.—Whether section 721 of the Code applies to the contribution of widely held developed or undeveloped real property or interests therein; widely held oil and gas properties or interests therein; or any similarly held properties or interests to a partnership in exchange for an interest in the partnership when (1) the contribution is the result of solicitation by promoters, brokers, or investment houses, or (2) the interest in the transferee partnership is issued in a form designed to render it readily tradable.

.16 Section 1031(a)(1).—Determination of Like-Kind Property in an Exchange of Businesses.—The manner in which like-kind property (other than real property) will be determined under section 1031 of the Code in a transaction involving the exchange of the assets of similar or identical businesses.

.17 Section 2503.—Taxable Gifts.—Whether the transfer of property to a trust will be a gift of a present interest in property when (1) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (2) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (3) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (4) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (5) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under sections 673 to 677 of the Code.

.18 Section 2514.—Powers of Appointment.—If the beneficiaries of a trust permit a power of withdrawal to lapse, whether section 2514(e) of the Code will be applicable to each beneficiary in regard to the power when (1) the trust corpus consists or will consist substantially of insurance policies on the life of the grantor or the grantor's spouse, (2) the trustee or any other person has a power to apply the trust's income or corpus to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse, (3) the trustee or any other person has a power to use the trust's assets to make loans to the grantor's estate or to purchase assets from the grantor's estate, (4) the trust beneficiaries have the power to withdraw, on demand, any additional transfers made to the trust, and (5) there is a right or power in any person that would cause the grantor to be treated as the owner of all or a portion of the trust under sections 673 to 677.

.19 Sections 3121, 3306, and 3401.—Employment Taxes.—Who is the employer of an "employee-owner" as defined in section 269A of the Code.

.20 Sections 3121 and 3306.—Definitions.—Whether payments made to former employees in the event of a plant closing, layoff, or reduction in force are wages for purposes of the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA).

.21 Section 7701.—Definitions.—The classification of separately tradable instruments that are issued by a corporation as a unit, the components of which collectively contain the attributes of stock.

.22 Section 7701.—Definitions.—The classification of an instrument that has certain voting and liquidation rights in an issuing corporation but whose dividend rights are determined by reference to the earnings of a segregated portion of the issuing corporation's assets, including assets held by a subsidiary.

SEC. 6. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Procs. 89-7, 89-19, 89-22, 89-26, 89-36, 89-39, 89-54, and 89-63 are superseded. Rev. Procs. 89-5, 89-12, and 89-67 are not superseded.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 90-3A

Rev. Proc. 90-3, page 402, this Bulletin, lists areas in which the Internal Revenue Service will not issue rulings or determination letters. This revenue procedure revises Rev. Proc. 90-3 to correct errors in sections 3.013, concerning section 105(h) of the Code, and 5.04, concerning sections 83 and 451 of the Code.

1. *Section 3.013*

Section 3.013 was deleted in error when Rev. Proc. 89-3, 1989-1 C.B. 761 was updated and restated in Rev. Proc. 90-3, 1990-1 I.R.B. 54. Accordingly, section 3 of Rev. Proc. 90-3 is hereby supplemented by reinserting section 3.013 of Rev. Proc. 89-3 as section 3.013(a) of Rev. Proc. 90-3, and redesignating existing section 3.013 as section 3.013(b). Section 1.02 of Rev. Proc. 90-3 is hereby corrected by striking out subsection 1, which noted the deletion of section 3.013 of Rev. Proc. 89-3, and redesignating subsections 2 through 15 as subsections 1 through 14.

The erroneously deleted and now reinstated section 3.013 material provides that the Service will not issue rulings or determination letters concerning:

"Section 105(h)—Amount Paid to Highly Compensated Individuals Under Discriminatory Self-Insured Medical Expense Reimbursement Plan.—Whether, following a determination that a self-insured medical expense reimbursement plan is discriminatory, that plan had previously made reasonable efforts to comply with tax discrimination rules."

2. *Section 5.04*

Rev. Proc. 89-22, 1989-1 C.B. 843, amplified section 5 of Rev. Proc. 89-3 by adding a new paragraph concerning sections 83 and 451 of the Code. In Announcement 89-42, 1989-13 I.R.B. 53, the Service corrected this paragraph, a portion of which was inadvertently omitted in publishing Rev. Proc. 89-22. When section 5 of Rev. Proc. 89-3 was updated and restated in Rev. Proc. 90-3, this paragraph was restated as it originally appeared in Rev. Proc. 89-22 without incorporating the correction made by Announcement 89-42.

Accordingly, section 5.04 of Rev. Proc. 90-3 is hereby clarified to provide that the Service will not issue rulings or determination letters concerning:

"Sections 83 and 451.—Property Transferred in Connection with Performance of Services; General Rule for Taxable Year of Inclusion.—When compensation is realized by a person who, in connection with the performance of services, is granted a nonstatutory option without a readily ascertainable fair market value *to purchase stock at a price that is less than the fair market value* of the stock on the date the option is granted." (Italicized material indicates inserted language.)

EFFECTIVE DATE

The changes set forth in this Rev. Proc. are effective as if included in Rev. Proc. 90-3.

EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 90-3 is supplemented and clarified. The changes set forth in this Rev. Proc. will be reflected in Rev. Proc. 90-3 when it is reprinted in 1990-1 C.B.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 90-4

CONTENTS

SECTION 1. PURPOSE
SECTION 2. SCOPE
SECTION 3. CHANGES
SECTION 4. GENERAL PRACTICE AND DEFINITIONS
SECTION 5. RULINGS AND OPINION LETTERS ISSUED BY THE NATIONAL OFFICE
SECTION 6. DETERMINATION LETTERS ISSUED BY KEY D TRICT DIRECTOR
SECTION 7. DISCRETIONARY AUTHORITY TO ISSUE RULINGS AND DETERMINATION LETTERS
SECTION 8. INSTRUCTIONS TO TAXPAYER
SECTION 9. CONFERENCES IN THE NATIONAL OFFICE
SECTION 10. KEY DISTRICT OFFICE REFERRAL OF MATTERS TO THE NATIONAL OFFICE
SECTION 11. REFERRAL OF MATTERS TO KEY DISTRICT OFFICES
SECTION 12. REVIEW OF DETERMINATION LETTERS
SECTION 13. WITHDRAWAL OR SUSPENSION OF REQUESTS
SECTION 14. ORAL ADVICE TO TAXPAYERS
SECTION 15. EFFECT OF RULINGS
SECTION 16. EFFECT OF DETERMINATION LETTERS
SECTION 17. EFFECT OF INFORMATION LETTERS
SECTION 18. PROCEDURE FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF RULINGS AND DETERMINATION LETTERS
SECTION 19. EFFECT ON OTHER DOCUMENTS
SECTION 20. EFFECTIVE DATE

SECTION 1. PURPOSE

The purpose of this revenue procedure is to update Rev. Proc. 83-36, 1983-2 C.B. 763, as amplified, modified, and supplemented, which provides procedures for issuing rulings, determination letters, opinion letters, notification letters and information letters, and for entering into closing agreements on specific issues involving the interpretation or application of the federal tax laws in the employee plans and exempt organizations areas. It also tells taxpayers and their representatives where to send requests for rulings, determination letters, opinion letters, notification letters and information letters. It gives the steps to follow so that requests may be handled more efficiently.

SEC. 2. SCOPE

.01 The Commissioner through the Assistant Commissioner (Employee Plans and Exempt Organizations) provides basic principles and rules for the uniform interpretation and application of the federal tax laws under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations).

.02 This revenue procedure applies only to ruling requests, opinion letters, notification letters, information letters, and closing agreements under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations) and to requests for determination letters under the jurisdiction of Key District Offices that relate to Code sections under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations).

.03 The procedures for obtaining rulings, closing agreements, and information letters on specific tax issues involving the interpretation or application of the federal tax laws under the jurisdiction of the Associate Chief Counsel (Technical) are contained in Rev. Proc. 90-1, page 356, this Bulletin. The jurisdiction of the Associate Chief Counsel (Technical) includes section 521 of the Code, on exemption of farmers' cooperatives from tax; section 526, on shipowners' protection and indemnity associations; and section 528 on certain homeowners associations.

.04 The procedures for obtaining rulings, etc., that apply to international transactions are contained in Rev. Proc. 87-4, 1987-1 C.B. 529, as modified by Rev. Proc. 88-4, 1988-1 C.B. 586.

SEC. 3. CHANGES

.01 The procedures of this revenue procedure are similar to the procedures of Rev. Proc. 90-1, page 356, this Bulletin, which provides procedures for issuing rulings, determination letters, and information letters, and for entering onto closing agreements under the jurisdiction of the Associate Chief Counsel (Technical). However, this revenue procedure varies from Rev. Proc. 90-1 where employee plans and exempt organizations considerations so require.

.02 Section 3.09 of Rev. Proc. 83-36, which defines a "closing agreement," has been redesignated as section 4.10, and has been expanded to provide that, in appropriate cases, a closing agreement will be made with sponsors of master and prototype plans.

.03 Section 4.01 of Rev. Proc. 83-36 has been redesignated, in part, as section 5.01, and has been modified to provide that, in employee plans matters, rulings will be issued on prospective transactions and on completed transactions either before or after the return is filed for those transactions.

.04 Section 4.01 of Rev. Proc. 83-36 has been redesignated, in part, as section 5.04, and has been expanded to set forth the Code sections within the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations).

.05 Section 5.05 has been added to clarify the jurisdiction of the National Office and the jurisdiction of the Key District Offices with respect to issues under sections 409 and 4975(e)(7) of the Code.

.06 Section 5.06 has been added to provide that requests for extensions of certain periods of time must be made no later than the later of the expiration of such time period or 120 days after the date of publication of this revenue procedure.

.07 Section 5.07 has been added to provide that, in exceptional circumstances, the National Office will issue rulings on employee plans qualification issues that are normally within

the jurisdiction of the Key District Office.

.08 Section 4.04 of Rev. Proc. 83-36, which set forth the criteria for determining whether a ruling letter will be issued when regulations are pending, was modified by Rev. Proc. 87-40, 1987-2 C.B. 514. Section 4.04 of Rev. Proc. 83-36, as modified, has been redesignated as section 5.10; Rev. Proc. 87-40 is superseded.

.09 Section 7 of Rev. Proc. 83-36 has been redesignated as section 8, and has been expanded to reflect the procedural requirements of Rev. Proc. 90-1.

.10 Section 8.03 has been added to reference the user fee requirements under Rev. Proc. 89-4, 1989-1 C.B. 767, as modified by Rev. Proc. 89-9, 1989-1 C.B. 780, and Rev. Proc. 89-13, 1989-1 C.B. 801.

.11 Section 9.07 has been added to note that, in certain cases, the Service will hold a conference prior to the submission of a ruling request.

SEC. 4. GENERAL PRACTICE AND DEFINITIONS

.01 The Service answers inquiries of individuals and organizations, when appropriate in the interest of sound tax administration, about their status for tax purposes and the tax effects of their acts or transactions, or in the interest of proper design and administration of employee benefit plans. The National Office issues rulings in such matters.

.02 Key District Directors of the Internal Revenue Service apply the statutes and tax treaties, regulations, revenue rulings, and other precedents published in the Internal Revenue Bulletin in determining tax liability, collecting taxes, and issuing information letters and determination letters in answer to taxpayers' inquiries or requests. For purposes of this revenue procedure, any reference to Key District Director or Key District Office includes their respective offices or, when appropriate, the Director of an Internal Revenue Service Center.

.03 The word "taxpayer" includes all persons subject to any provision of the Internal Revenue Code and, when appropriate, their representatives. Any reference to National Office means only the Office of the Assistant Commissioner (Employee Plans and Exempt Organizations).

.04 A "ruling" is a written statement issued to a taxpayer by the National Office that interprets and applies the tax laws or any non-tax laws applicable to employee benefit plans and exempt organizations for which the Service has jurisdiction to that taxpayer's specific set of facts. Rulings are issued only by the National Office, under the general supervision of the Assistant Commissioner (Employee Plans and Exempt Organizations). Issuing rulings has been largely redelegated to the Directors of the Employee Plans Technical and Actuarial Division and the Exempt Organizations Technical Divisions.

.05 A "determination letter" is a written statement issued by a Key District Director in response to a written inquiry by a taxpayer that applies the principles and precedents previously announced by the National Office to a specific set of facts. A determination letter is issued only when a determination can be made on the basis of clearly established rules in the statute or regulations, or by a position in a ruling, opinion, or court decision published in the Internal Revenue Bulletin that specifically answers the question presented. A determination letter will not be issued if a determination cannot be made, for example, when the question presents a novel issue, or if the matter is excluded from the jurisdiction of a Key District Director under section 6 of this revenue procedure. District Directors of Key District Offices shall issue determination letters involving the provisions of section 401, 403(a), 409, and 4975(e)(7) of the Code as provided in Rev. Proc. 80-30, 1980-1 C.B. 685.

.06 A "notification letter" is a written statement furnished by the National Office or a Key District Office, upon request, as to the acceptability (for purposes of sections 401 and 501(a) of the Internal Revenue Code) of the form of a regional prototype plan and any related trust or custodial account. See Rev. Proc. 89-13, 1989-1 C.B. 801.

.07 An "opinion letter" is a written statement issued by the National Office to a sponsoring organization as to the acceptability (for purposes of sections 401 and 501(a) of the Code) of the form of a master or prototype plan and any related trust or custodial account under sections 401, 403(a), and 501(a) of the Code, or as to the conformance of a prototype trust, custodial account, or individual annuity with the requirements of section 408(a), (b), or (k), as applicable. See Rev. Proc. 87-50, 1987-2 C.B. 647, and Rev. Proc. 89-9, 1989-1 C.B. 780.

.08 An "information letter" is a statement issued either by the National Office or by a Key District Director that calls attention to a well-established interpretation or principle of tax law, without applying it to a specific set of facts. It may be issued if the request indicates that the taxpayer is seeking general information. If the request does not meet the requirements of section 8 of this revenue procedure, but the Service thinks that the general information may help the individual or organization, it may issue an information letter.

.09 A "revenue ruling" is an interpretation by the Service that has been published in the Internal Revenue Bulletin. It is the conclusion of the Service on how the law is applied to an entire set of facts. Revenue rulings are issued only by the National Office and are published for the information and guidance of taxpayers, Internal Revenue Service officials, and other interested parties.

Since each revenue ruling represents the conclusion of the Service as to the application of the law to the entire statement of facts involved, taxpayers, Service personnel, and others concerned are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same. They should consider the effect of subsequent legislation, regulations, court decisions, and revenue rulings. See Rev. Proc. 89-14, 1989-1 C.B. 814.

.10 A "closing agreement" is an agreement between the Commissioner of Internal Revenue or the Commissioner's delegate and a taxpayer on a specific issue or issues or liability that is entered into under the authority in section 7121 of the Code. A closing agreement prepared in an office under the responsibility of the Assistant Commissioner (Employee Plans and Exempt Organizations) is based on a

ruling that has been signed by the Commissioner or the Commissioner's delegate that says that a closing agreement will be entered into on the basis of the holding of the ruling letter. Closing agreements are final, unless fraud, malfeasance, or misrepresentation of a material fact can be shown. Closing agreements may be entered into when it is advantageous to have the matter permanently and conclusively closed, or when a taxpayer can show good and sufficient reasons for an agreement and the government will sustain no disadvantage by its consummation. In appropriate cases, taxpayers may be asked to enter into a closing agreement as a condition to the issuing of a ruling. If, in a single case, closing agreements are requested for each of a number of taxpayers, such agreements are entered into only if the number of taxpayers is 25 or less. However, if the issue and holding are identical for all taxpayers and they number more than 25, a "mass closing agreement" will be entered into with the taxpayer who is authorized by the others to represent the entire group. In appropriate cases, closing agreements may be made with sponsors of National Office master and prototype plans and sponsors of regional prototype plans. District Directors have authority to enter into closing agreements regarding employee plans matters, notwithstanding the delegation of authority to the Commissioner's delegate.

SEC. 5. RULINGS AND OPINION LETTERS ISSUED BY THE NATIONAL OFFICE

.01 In exempt organizations matters, the National Office issues rulings on prospective transactions and on completed transactions that occurred before the return is filed for the year in which such transactions are consummated. In employee plans matters, the National Office issues rulings on prospective transactions and on completed transactions either before or after the return is filed for those transactions.

.02 The National Office usually will not issue rulings if, at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period and (1) that issue is under examination by a Key District Director or under consideration by an Appeals Office, or (2) that issue has been examined by a Key District Director or considered by an Appeals Office and the statutory period of limitation on either assessment or for filing a claim for refund or credit of tax has not expired, or a closing agreement covering the issue or liability has not been entered into by a Key District Director or by an Appeals Office. However, if a Key District Director has begun an examination of the issue involved in the ruling request, the National Office usually will issue the ruling if the Key District Director agrees, by memorandum, to permit the ruling to be issued.

.03 In exempt organizations matters, the National Office issues rulings as to the application of the federal tax laws involving:

(1) Organizations exempt from tax under section 501, including private foundations;

(2) Organizations described in section 170(b)(1)(A) (except clause (V));

(3) Political organizations described in section 527;

(4) Organizations described in section 4947(a);

(5) Prepaid legal plans described in section 120; and

(6) Welfare benefit plans described in section 4976.

.04 In employee plans matters, the National Office issues rulings involving:

(1) Sections 401 through 419A, except as provided in section 3 of Rev. Proc. 80-30; sections 72, 101(d), 219, 381(c)(11), 511 through 514, 4971, 4972, 4973, 4974, 4978, 4979, 4980, and 4980A;

(2) Waiver of the minimum funding standard, changes in funding method, and changes in the plan year under section 412;

(3) A change in the plan year of an employee retirement plan and the trust year of a tax-exempt employees' trust (See Rev. Proc. 87-27, 1987-1 C.B. 769);

(4) The tax consequences of prohibited transactions under sections 503 and 4975;

(5) The National Office issues opinion letters as to the acceptability of the form of master or prototype plans and any related trusts or custodial accounts involving sections 401, 403(a) and 501(a), and of prototype trusts, custodial accounts or annuities under section 408(a), (b), or (k), only to the extent provided in Rev. Procs. 87-50 and 89-9.

(6) The National Office issues rulings as to whether individual retirement accounts established by employers or associations of employees meet the requirements of section 408(c). (See Rev. Proc. 87-50.)

.05 With respect to transactions involving employee stock ownership plans under section 4975(e)(7) of the Code and tax credit employee stock ownership plans under section 409, the Assistant Commissioner (Employee Plans and Exempt Organizations) will issue rulings involving sections 409(l), 409(m), and 4975(d)(3). Other subsections of section 409 and section 4975(e)(7) involve qualification issues within the jurisdiction of the Key District Offices.

.06 Where the Assistant Commissioner (Employee Plans and Exempt Organizations) has authority to grant extensions of certain periods of time within which the taxpayer must perform certain transactions (for example, the 90 day period for reinvesting in employer securities under section 1.46-8(e)(10) of the regulations), the taxpayer's request for an extension of such time period must be postmarked (or received, if hand delivered to the National Office) no later than the later of the expiration of the original time period or 120 days after the date of publication of this revenue procedure. Thus, for example, a request for an extension of the 90 day period for reinvesting in employer securities under section 1.46-8(e)(10) must be made no later than the later of the expiration of the original reinvestment period or 120 days after the date of publication of this revenue procedure. However, see section 5.08 with respect to elections under section 1.9100-1 of the regulations.

.07 Although the Assistant Commissioner (Employee Plans and Exempt Organizations) will not ordinarily issue rulings on matters involving plan qualification, rulings may be issued where (1) the taxpayer demon-

strates to the Service's satisfaction that the qualification issue involved is unique and requires immediate guidance, (2) as a practical matter, it is not likely that such issue will be addressed through the determination letter process, and (3) the Service determines that it is in the interest of good tax administration to provide guidance to the taxpayer with respect to such qualification issue.

.08 With regard to applications for extension of the time for making an election or application for relief pursuant to section 1.9100-1 of the Income Tax Regulations, see Rev. Proc. 79-63, 1979-2 C.B. 578. If a request for an extension of time under section 1.9100-1 is submitted before or after the return is filed but before the return is examined, the procedures of this revenue procedure are applicable. If an examination of the return has begun, or is being considered by an Appeals office, the procedures of Rev. Proc. 90-5, page 421, this Bulletin, are applicable.

.09 The National Office does not issue rulings to business, trade, or industrial associations or to similar groups concerning the application of the tax laws to members of the group. It may, however, issue rulings to these groups or associations on their own tax status or liability if the request meets the requirements of this section. Furthermore, such groups or associations may submit suggestions of generic issues that would be appropriately addressed in revenue rulings.

.10 Pending the adoption of regulations (either temporary or final) that interpret the provisions of any act, the issuing of rulings will be considered under the following conditions.

(1) If the ruling request presents an issue on which the answer seems clear by applying the statute to the facts, a ruling will be issued under the usual procedures.

(2) If the ruling request presents an issue on which the answer seems reasonably certain but not entirely free from doubt, a ruling will be issued.

(3) For Code sections 402(a)(5), 402(a)(6), 402(f)(2)(A), 403(a)(1), 403(b)(1), and 72(t), which were enacted or amended by the Tax Reform Act of 1986 or the Revenue Act of 1987, the appropriate Branch will entertain all ruling requests and do its best to issue a ruling even if the answer does not seem reasonably certain. However, if the ruling request presents an issue that cannot be readily resolved before regulations are issued, a ruling will not be issued.

(4) Where the Service has closed a regulations project or does not intend to open a regulations project, the appropriate Branch will entertain all ruling requests unless the issue is covered by section 7 of this revenue procedure or the no-ruling provisions of Rev. Proc. 80-30.

SEC. 6. DETERMINATION LETTERS ISSUED BY KEY DISTRICT DIRECTORS

.01 In employee plans and exempt organizations matters, Key District Directors issue determination letters only if the question presented is specifically answered by statute or regulation, or by a position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin. Key District Directors issue determination letters in response to taxpayers' written requests on proposed and completed transactions that affect returns over which they have examination jurisdiction. A determination letter usually is not issued for a question concerning a return to be filed by the taxpayer if the same question is involved in a return already filed.

.02 Notwithstanding the provisions of section 6.01, even though a request presents a question specifically answered by statute or regulation, or by a position stated in a ruling, opinion or court decision published in the Internal Revenue Bulletin, a Key District Director will not issue a determination letter in response to the request (1) if it appears that the taxpayer has directed a similar inquiry to the National Office, (2) the same issue involving the same taxpayer is pending in a case before an Appeals Office, (3) the determination letter is requested by an industry, trade association, or similar group on behalf of individual taxpayers within the group (other than subordinate organizations covered by a group exemption letter), or (4) the request involves an industry-wide problem. Under no circumstances will a Key District Director issue a determination letter unless it is clearly shown that the request concerns a return which has been filed or is required to be filed and over which the Key District Director has or will have examination jurisdiction.

.03 Key District Directors issue determination letters as to the qualification of plans involving sections 401, 403(a), 409, and 4975(e)(7) of the Code, and the exempt status of related trusts, if any, under section 501, as provided in Rev. Proc. 80-30.

.04 Key District Directors also issue determination letters as to:

(1) Qualification for exempt status of organizations described in sections 501 and 521 to the extent provided in Rev. Proc. 84-46, 1984-1 C.B. 541;

(2) Classification of private foundation status as provided in Rev. Proc. 76-34, 1976-2 C.B. 656;

(3) Recognition of unusual grants to certain organizations under sections 170(b)(1)(A)(vi) and 509(a)(2); and

(4) Advance approval under section 4945(g) of organizations' grant making procedures whose applications disclose (or who have otherwise properly disclosed) a scholarship grant program or plans to conduct such a program. If questions arise regarding grant-making procedures that cannot be resolved on the basis of law, regulations, a clearly applicable revenue ruling, or other published precedent, the Key District Director will forward the matter to the National Office for technical advice.

.05 Key District Offices issue notification letters as to the acceptability of the form of regional prototype plans and any related trusts or custodial accounts involving sections 401 and 501(a) of the Code only to the extent provided in Rev. Proc. 89-13, 1989-1 C.B. 801.

.06 A request received by a Key District Director on a question concerning a return already filed will be, in general, considered in connection with the examination of the return. If a response is made to such a request before the return is examined, it will be considered a tentative finding in any later examination of that return.

SEC. 7. DISCRETIONARY AUTHORITY TO ISSUE RULINGS AND DETERMINATION LETTERS

.01 The Service ordinarily will not issue rulings or determination letters

in certain areas because of the factual nature of the problem involved, or for other reasons. The Service may decline to issue a ruling or a determination letter on other grounds, whenever warranted by the facts or circumstances of a particular case. The National Office and Key District Directors may, when it is considered appropriate and in the best interest of the Service, issue information letters calling attention to well-established principles of tax law.

.02 A ruling or a determination letter is not issued on alternative plans of proposed transactions or on hypothetical situations.

.03 The National Office ordinarily will not issue rulings on only part of an integrated transaction.

.04 The National Office will issue rulings in all cases on prospective or future transactions if the law or regulations require a determination of the effect of a proposed transaction for tax purposes.

.05 A ruling or determination letter relating to an issue that is being considered by the Pension Benefit Guaranty Corporation or the Department of Labor, and involves the same taxpayer, shall be issued at the discretion of the Service.

SEC. 8. INSTRUCTIONS TO TAXPAYER

.01 The taxpayer should submit a request for a ruling or a determination letter in duplicate if (1) more than one issue is presented in the request, or (2) a closing agreement is requested on the issue presented. It is not necessary to submit requests in duplicate under other circumstances except as set forth in section 8.12.

.02 A request for a ruling or determination letter and any factual information or change in the ruling request submitted at a later time must be accompanied by a declaration in the following form: "Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the requested ruling or determination letter are true, correct, and complete." The declaration may not be made by the taxpayer's representative. It must be signed by the person or persons on whose behalf the request is made. The person who signs for a corporate taxpayer must be an officer of the corporate taxpayer who has personal knowledge of the facts. The officer must be one whose duties are not limited to obtaining a ruling or determination letter from the Service. Furthermore, if the corporate taxpayer is a member of an affiliated group filing consolidated returns, a penalties-of-perjury statement must also be submitted by the common parent of the group. The person signing for a trust or partnership must be a trustee or general partner who has personal knowledge of the facts. If multiple submissions of additional factual information are made, one declaration that refers specifically to each of the additional submissions may be provided.

.03 Section 10511 of the Revenue Act of 1987, Pub. L. 100-203, enacted December 22, 1987, requires the payment of user fees for requests for rulings, opinion letters, determination letters, and similar requests. Rev. Proc. 89-4, which was modified by Rev. Proc. 89-13, contains the schedule of fees and provides guidance for administering the user fee requirements. The amount of user fee payable with respect to each category of submission under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations) is set forth in Rev. Proc. 89-4, and Rev. Proc. 89-13.

.04 If more than one issue is presented in a request for a ruling, the Service generally will issue a single ruling letter. However, the taxpayer may request a separate ruling letter on any of the issues. Unless the Service determines that it is not feasible or not in the best interest of the Service to comply with such a request, it will issue separate ruling letters.

.05 When multiple issues are involved in a single factual situation and separate letters requesting rulings are submitted, a statement to this effect must be included in each ruling letter request. The Service in issuing each ruling will state that separate rulings have been issued or requests for rulings are pending.

.06 Each request for a ruling or a determination letter must contain a complete statement of all of the facts relating to the transaction. Such facts include: names, addresses, telephone numbers, and taxpayer identification numbers of all interested parties; the location of the District Office that has or will have examination jurisdiction over the return, not the Service Center where the return is filed, a full and precise statement of the business reasons for the transaction, and a carefully detailed description of the transaction. (The term "all interested parties" is not to be construed as requiring a list of employees where a large number may be involved in a plan). If the request deals with only one step of a larger integrated transaction, the facts, circumstances, etc. relating to the entire transaction must be submitted. However, see section 7.03 of this revenue procedure. In addition, true copies of all contracts, wills, deeds, agreements, instruments, plan documents, trust agreements, and other documents in the transaction must be submitted with the request. Original documents, such as contracts, wills, etc., should not be submitted because they become part of the Service's file and will not be returned. All material facts in documents must be included in the taxpayer's letter requesting a ruling or in supplemental letters, and not merely incorporated by reference, and must be accompanied by an analysis of their bearing on the issue or issues, specifying the provisions that apply.

Material facts furnished to the Service by telephone or orally at a conference must be promptly confirmed by letter to the Service with a declaration in the form described in section 8.02. This confirmation must be furnished within 21 calendar days to be considered part of the request. An extension of the 21-day period will be granted only if justified in writing by the taxpayer and approved by the Branch Chief or group manager to whom the case is assigned. A request for extension should be submitted before the end of the 21-day period. If unusual circumstances close to the end of the 21-day period make a written request impractical, within the 21-day period the National Office should be told of the problem and that the written request for extension will be coming soon. Such a request must be sent promptly. The taxpayer or taxpayer's representative will be told promptly and later in writing of the approval or denial of the requested extension. There is no right of appeal to a denial of an extension request. Because the purpose of these

procedures is to speed up the ruling process, the taxpayer is encouraged to submit the required relevant material promptly. Therefore, requests for extensions should be justified by compelling facts and circumstances. If the Service is not made aware, as provided above, of problems in meeting the 21-day period, or if the request is not sent promptly after the National Office is notified of problems in meeting the 21-day period, the Service will process the case on the assumption that no further submission will be received.

.07 The request must contain a statement of whether, to the best of the knowledge of the taxpayer and the taxpayer's representative(s), if any, the identical issue is in a prior return of the taxpayer (or in a return for any year of a related taxpayer within the meaning of section 267 of the Code, or of a member of an affiliated group of which the taxpayer is also a member within the meaning of section 1504). If so, the statement must specify whether the issue (1) is being examined by a Key District Director, (2) has been examined and the statutory period of limitation on either assessment or for filing a claim for refund or credit of tax has not expired, or a closing agreement covering the issue or liability has not been entered into by a Key District Director, (3) is being considered by an Appeals Office in connection with the taxpayer's return for an earlier period, or has been considered by an Appeals Office and the statutory period of limitation on either assessment or for filing a claim for refund or credit of tax has not expired, or a closing agreement covering the issue or liability has not been entered into by an Appeals Office, (4) is pending in litigation in a case involving the taxpayer or a related taxpayer, or (5) in the case of employee plans, is being considered by the Pension Benefit Guaranty Corporation or the Department of Labor. The request must also contain a statement whether, to the best of the knowledge of the taxpayer and the taxpayer's representative(s), if any, the identical or similar issue has been (i) submitted to the Service by the taxpayer or its predecessor, but withdrawn before a ruling was issued, or (ii) ruled on by the Service for the taxpayer or for the taxpayer's predecessor. If so, the statement must specify the date of submission, withdrawal, or ruling and other details of the Service's consideration of the issue. If, after the request is filed but before a ruling is issued, the taxpayer knows that an examination of the issue by a Key District Director has been started, the taxpayer must notify the National Office of such action. If a return is filed before a ruling is received from the National Office concerning the issue, a copy of the request must be attached to the return. This alerts the Key District Office and avoids premature Key District action on the issue.

.08 If the taxpayer advocates a particular conclusion, an explanation of the grounds for the assertion must be furnished, together with a statement of relevant authorities in support of the taxpayer's views. Even though the taxpayer is urging no particular tax treatment of a proposed or prospective transaction, the taxpayer's views on the tax results of the proposed action and a statement of relevant authorities to support those views must be furnished. In addition, the taxpayer is encouraged to inform the Service, and discuss the implications of any legislation, tax treaties, court decisions, regulations, revenue rulings or revenue procedures that the taxpayer determines to be contrary to the position advanced. If the taxpayer determines that there are no contrary authorities, a statement in the ruling request to this effect would be helpful. Identification and discussion of contrary authorities will generally enable Service personnel to arrive more quickly at a full understanding of the issue and the relevant authorities. There is a further advantage to the taxpayer. When Service personnel receive the request, they will have before them the taxpayer's thinking on the effect and applicability of contrary authorities. Such information should, therefore, make research easier and lead to earlier action by the Service. Conversely, failure to disclose and distinguish significant contrary authorities may result in requests for additional information that will delay action on the ruling request.

.09 If the request is with respect to the qualification of a plan involving section 401, 403(a), or 408 of the Code, or conformance of an employee stock ownership plan to sections 409 and 4975(e)(7) of the Code, see Rev. Procs. 80-30, 87-50, and 89-13.

.10 If the request is with respect to the qualification of an organization for exemption from federal income tax under section 501 or 521, see Rev. Procs. 72-5, 1972-1 C.B. 709; 80-27, 1980-1 C.B. 677; and 84-46, 1984-1 C.B. 541.

.11 Section 6110(a) of the Code requires that the text of any written determination and related background file document be open to public inspection in the manner provided in the regulations. However, section 6110(k)(1) states that section 6110 disclosure provisions do not apply to any matter to which section 6104 applies. Therefore, rulings, determination letters, technical advice memoranda, and related background file documents dealing with the following matters (covered by section 6104) are not subject to section 6110 disclosure provisions:

(1) An application for exemption under section 501(a) as an organization described in section 501(c) or (d), or any application filed with respect to the qualification of a pension, profit-sharing or stock bonus plan, or an individual retirement account, whether the plan or account has more than 25 or less than 26 participants, or any application for exemption under section 501(a) by an organization forming part of such a plan or account;

(2) Any document issued by the Internal Revenue Service in which the qualification or exempt status of an organization, plan, or account is granted, denied, or revoked or the portion of any document in which technical advice with respect thereto is given to a District Director;

(3) Any application filed and any document issued by the Internal Revenue Service with respect to the qualification or status of National Office master and prototype plans, and regional prototype plans;

(4) The portion of any document that is issued by the Internal Revenue Service in which is discussed the effect on the qualification or exempt status of an organization, plan, or account, of a proposed transaction by such organization, plan, or account; and

(5) Any document issued by the Internal Revenue Service in which is discussed the status of an organization under section 509(a) or 4942(j)(3), other than one issued to a

nonexempt charitable trust described in section 4947(a)(1). This includes documents discussing the termination of private foundation status under section 507.

.12 To assist the Service in making the deletions required by section 6110(c) of the Code from the text of rulings and determination letters to be made open to public inspection under section 6110(a), a deletions statement must accompany each request. The statement must either state that no information other than names, addresses, and identifying numbers need be deleted or, if more information is proposed to be deleted, the statement must indicate the deletions proposed by the person requesting the ruling or determination letter. If the latter alternative is chosen, the statement must be made in a separate document, and it must be accompanied by a copy of the request for a ruling or determination letter and supporting documents, on which must be shown, by the use of brackets, the material that the person making the request believes should be deleted pursuant to section 6110(c). The statement of proposed deletions must indicate the statutory basis, under section 6110(c), for each proposed deletion. The statement of proposed deletions must not appear or be referred to anywhere in the request for a ruling or determination letter. If the person making the request decides to ask for additional deletions before the ruling or determination letter is issued, additional statements may be submitted. The procedures in this paragraph also apply to additional information that is submitted after the initial request.

.13 A request by or for a taxpayer must be signed by the taxpayer or the taxpayer's authorized representative. If the request is signed by a representative, or if the representative is to appear before the Service in connection with the request, the representative must be:

(1) An attorney who is a member in good standing of the bar of the highest court of any state, possession, territory, commonwealth, or the District of Columbia, and who files with the Service a written declaration that he or she is currently qualified as an attorney and is authorized to represent the taxpayer;

(2) A certified public accountant who is qualified to practice in any state, possession, territory, commonwealth, or the District of Columbia, and who files with the Service a written declaration that he or she is currently qualified as a certified public accountant and is authorized to represent the taxpayer;

(3) A person, other than an attorney or certified public accountant who is currently enrolled to practice before the Service including, in the case of matters involving employee plans, a person enrolled to practice only for employee plans matters, and who files with the Service a written declaration that he or she is currently enrolled (including in the declaration either the enrollment number or the expiration date of the enrollment card) and is authorized to represent the taxpayer. (See Treasury Department Circular No. 230 (31 CFR Part 10), 1983-2 C.B. 742, for the rules on who may practice before the Service); or

(4) A foreign representative who has received a "Letter of Authorization" from the Director of Practice, pursuant to section 10.7(b) of Treasury Department Circular No. 230. Practitioners may make a written request for a "Letter of Authorization" to: Office of Director of Practice, HR:DP, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224. Section 10.7(b) of Circular No. 230 authorizes the Commissioner to allow any person to represent another without enrollment for the purpose of a particular matter. Without a "Letter of Authorization," the foreign representative may not represent the taxpayer before the Service.

For purposes of section 8.13, a request includes a volume submitter lead plan and a regional prototype plan. The requirements above do not apply to an individual representing his or her fulltime employer, or to a bona fide officer, administrator, administratrix, trustee, etc., representing a corporation, trust, estate, association, or organized group. An unenrolled preparer of a return (other than an attorney or certified public accountant referred to in (1) and (2) above) who is not a full-time employee or a bona fide officer, administrator, administratrix, trustee, etc., may not represent a taxpayer in connection with a ruling or a determination letter.

Any authorized representative, whether or not enrolled to practice, must also comply with the conference and practice requirements of the Statement of Procedural Rules (26 CFR 601). Form 2848, Power of Attorney and Declaration of Representative, and Form 2848-D, Tax Information Authorization and Declaration of Representative, may be used with regard to rulings, closing agreements, and determination letters requested under this revenue procedure and Rev. Procs. 72-5, 1972-1 C.B. 709; 75-48, 1975-2 C.B. 583; 76-32, 1976-2 C.B. 654; 84-46, 1984-1 C.B. 541; and 80-30, 1980-1 C.B. 685.

.14 If a taxpayer has more than one representative, it is sufficient to send a copy of the ruling to any one of them. Copies of a ruling will be sent to no more than two representatives, provided that they are located at different mailing addresses. If a taxpayer does not designate which representative is to receive a copy of the ruling, a copy of the ruling will be sent to the first representative named on the latest power of attorney. If the original of the ruling is to be sent to a representative, the power of attorney should contain a statement to that effect and designate the mailing address of the representative.

.15 Taxpayers should address their requests for rulings, with the appropriate user fee, as follows:

Employee Plans Rulings
Internal Revenue Service
Assistant Commissioner (EP/EO)
Attention: E:EP:R
P.O. Box 14073, Ben Franklin Station
Washington, D.C. 20044

Exempt Organizations Rulings
Internal Revenue Service
Assistant Commissioner (EP/EO)
Attention: E:EO
P.O. Box 120, Ben Franklin Station
Washington, D.C. 20044

Requests may be hand delivered to Room 6052, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, between 8:30 a.m. and 4:00 p.m. on working days. A request for a determination letter should be sent to the Key District Director of Internal Revenue whose office has or will have examination jurisdiction over the taxpayer's return. See Rev. Procs. 80-30, 84-46, and 89-13.

.16 A request for an information letter on employee plans matters

should be sent to Internal Revenue Service, 1111 Constitution Ave., N.W., Employee Plans Rulings Branch, Room 6550, Washington, D.C. 20224.

.17 A request for a notification letter by the Key District Office should be addressed in accordance with the procedures of Rev. Proc. 89-13 in the case of regional prototype plans.

.18 If a request for a ruling or determination letter does not comply with all the provisions of this revenue procedure, the request will be acknowledged and the requirements that have not been met will be pointed out. If a request for a ruling lacks essential information, the taxpayer will be told that if the information is not received within 30 calendar days, the request will be closed. If the information is received after the request is closed, it will be reopened and treated as a new request as of the date the essential information is received. Section 6.09(1)(b) of Rev. Proc. 89-4 charges a new user fee for a case that is reopened under these circumstances. A request for a ruling letter sent to the Key District Director that does not comply with the provisions of this revenue procedure will be returned by the Key District Director for corrections before it is sent directly to the National Office.

.19 A taxpayer who wants to have a conference on the issue or issues involved should indicate this in writing when, or soon after, filing the request.

.20 The Service processes requests for rulings and determination letters in regular order and as expeditiously as possible. Consideration of a request for processing ahead of its regular order, or by a specified time, delays the processing of other matters. Requests for processing ahead of the regular order must be made in writing, preferably in a separate letter with, or soon after, the request. If the request is not made in a separate letter, then the letter in which the request is made should say, at the top of the first page: "Expeditious Handling Is Requested. See page ___ of this letter." The request should give a compelling need for such treatment. The Service cannot give assurance that any letter will be processed by the time requested. For example, the scheduling of a closing date for a transaction or a meeting of the board of directors or shareholders of a corporation, without regard for the time it may take to obtain a ruling or determination letter, will not be considered sufficient reason for handling a request ahead of its regular order. Nor will the possible effect of fluctuation in the market price of stocks on a transaction be considered sufficient reason for handling a request out of order. Requests by telegram will be treated in the same manner as requests by letter. Rulings and determination letters ordinarily are not issued by telegram. A request for expeditious handling will not cause the Communications and Records Unit to route the case to the Rulings Branch ahead of normal processing; and a request for expeditious handling will not be considered until the underlying ruling request has been found to satisfy the section 6110 requirements where applicable.

.21 The Director, Exempt Organizations Technical Division, has primary responsibility for issuing rulings with respect to organizations exempt from income tax. The Director, Employee Plans Technical and Actuarial Division, has primary responsibility for matters involving the qualification of pension, annuity, profit-sharing, and stock bonus plans; the tax treatment of employees and their beneficiaries and deductions for employer contributions under such plans, the applicability of the tax on prohibited transactions under section 4975 of the Code, and for matters requiring actuarial determinations.

.22 A taxpayer may obtain information regarding the status of a request by calling the person whose name and telephone number is shown on the acknowledgment of receipt of the request.

.23 After receiving the notice under section 6110(f)(1) of the Code of intention to disclose the ruling or determination letter (including a copy of the version proposed to be open to public inspection and notification of third-party communications under section 6110(d)), the person requesting the ruling or determination letter may protest the disclosure of certain information in the ruling or determination letter. That person must within 20 calendar days send a written statement to the Internal Revenue Service office indicated on the notice of intention to disclose identifying those deletions that the Service has not made and that the person requesting the ruling or determination letter believes should have been made. That person must also submit a copy of the versions of the ruling or determination letter proposed to be open to public inspection on which the person indicates, by use of brackets, the deletions proposed by the taxpayer that have not been made by the Service. Generally, the Service will not consider the deletion under this subparagraph of any material that the taxpayer did not propose to be deleted before the ruling or determination letter was issued. Within 20 days after it receives the response to the notice under section 6110(f)(1), the Service will mail to that person its final administrative conclusion regarding the deletions to be made. The taxpayer does not have the right to a conference to resolve any disagreements concerning material to be deleted from the text of the ruling. However, these matters may be taken up at any conference that is otherwise scheduled regarding the request.

.24 After receiving the notice under section 6110(f)(1) of the Code of intention to disclose (but not later than 60 calendar days after the notice is mailed), the person requesting a ruling or determination letter may send a request for delay of public inspection under either section 6110(g)(3) or (4). The request for delay must be sent to the Internal Revenue Service office indicated on the notice of intention to disclose. A request for delay under section 6110(g)(3) must contain the date on which it is expected that the underlying transaction will be completed. The request for delay under section 6110(g)(4) must contain a statement from which the Commissioner may determine that there are good reasons for the delay.

.25 A taxpayer who receives a ruling or determination letter before filing a return about any transaction that has been consummated and that is relevant to the return being filed should attach a copy of the ruling or determination letter to the return when it is filed.

.26 In those situations when the National Office believes that the taxpayer's representative is not in compliance with Treasury Department Circular No. 230, the National Office

and Key District Office will bring the matter to the attention of the Director of Practice.

SEC. 9. CONFERENCES IN THE NATIONAL OFFICE

.01 A taxpayer may request a conference only in connection with a ruling request. Normally, a conference is scheduled only when the National Office considers it to be helpful in deciding the case or when an adverse decision is indicated. If conferences are being arranged for more than one request for a ruling involving the same taxpayer, they will be scheduled so as to cause the least inconvenience to the taxpayer. If a conference has been requested, the taxpayer will be notified by telephone, if possible, of the time and place of the conference. The conference must be held within 21 calendar days after such contact has been made. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those stated in section 8.06.

.02 A taxpayer is entitled, as a matter of right, to only one conference in the National Office unless one of the circumstances discussed in section 9.05 develops. This conference normally will be held at the Branch level of the appropriate division in the office of Assistant Commissioner (Employee Plans and Exempt Organizations) and will be attended by a person who, at the time of the conference, has authority to sign the ruling letter in his or her own name or for the Branch Chief in the case being discussed. When more than one Branch of the Service has taken an adverse position on an issue within its jurisdiction presented in a ruling request, or when the position ultimately adopted by one Branch of the Service will affect another Branch's determination, a representative from each Branch with the authority to sign in his or her own name or for the Branch Chief will attend the conference. If more than one subject is to be discussed at the conference, the discussion will constitute a conference on each subject. In order to promote a free and open discussion of the issues, the conference usually will be held after the Branch has had an opportunity to study the case. However, at the request of the taxpayer or representative, the conference of right may be held at an earlier stage in the consideration of the case than the Service ordinarily would designate. No taxpayer has a "right" to appeal the action of a Branch to the Division Director or to any other official of the Service.

.03 Since conference procedures are informal, no tape, stenographic, or other verbatim recording of a conference will be made.

.04 The senior Service representative present at the conference insures that the taxpayer has full opportunity to present views on all of the issues that are in question. The Service representative explains the Service's tentative decision on the substantive issues and the reason for that decision. If the taxpayer advances prospective application under section 7805(b) of the Code, the Service representative will discuss the tentative recommendation concerning the request for relief and the reason for the tentative recommendation. No commitment can be made as to the conclusion that the Service will finally adopt.

.05 An invitation to an additional conference will be extended if, after the conference of right, an adverse holding is proposed but on a new issue or on the same issue but on different grounds from those discussed at the first conference. There is no right to another conference when a proposed holding is reversed at a higher level with a result less favorable to the taxpayer if the ground or arguments on which the reversal is based were discussed at the conference of right. The provision of this revenue procedure limiting the number of conferences to which a taxpayer is entitled will not prevent a taxpayer from attending further conferences when, in the opinion of National Office personnel, such conferences are necessary. All additional conferences of the type discussed in this paragraph are held only at the invitation of the Service.

.06 It is the responsibility of the taxpayer to furnish in writing to the National Office any additional data, lines of reasoning, precedents, etc., that are proposed by the taxpayer and discussed at the conference but that were not previously or adequately presented in writing. The taxpayer must furnish the additional information within 21 calendar days. If the additional information is not received within that time, a ruling will be issued on the basis of the information on hand or, if appropriate, no ruling will be issued. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those stated in section 8.06.

.07 In certain instances, it will be advantageous to both the Service and the taxpayer to hold a conference prior to submission of a ruling request to discuss substantive or procedural issues relating to a proposed transaction. Where the taxpayer intends to file a ruling request, presubmission conferences will be held on a time-available basis, and generally the taxpayer will be requested to provide a draft ruling request or other detailed written description of the proposed transaction prior to the conference. Any discussion of substantive issues at a presubmission conference is advisory only, is not binding on the Service, and cannot be relied upon as a basis for obtaining retroactive relief under the provisions of section 7805(b) of the Code. A ruling request submitted following the pre-submission conference will not necessarily be assigned to the Branch or office that held the pre-submission conference.

SEC. 10. KEY DISTRICT OFFICE REFERRAL OF MATTERS TO THE NATIONAL OFFICE

.01 Requests for determination letters received by Key District Directors that, under the provisions of this revenue procedure, may not be acted upon by a Key District Office, will be forwarded to the National Office for reply. The Key District Office will let the taxpayer know that this action has been taken. Key District Directors will also refer to the National Office any request for a determination letter that in their judgment should have the attention of the National Office. See also the provisions of Rev. Proc. 80-30 and Rev. Proc. 89-9 with respect to requests relating to qualification of a plan involving sections 401 and 403(a) of the Code, and Rev. Procs. 72-5, 80-27 and 84-46 with respect to applications for recognition of exempt status under sections 501 and 521.

.02 If the request involves an issue on which the Service will not issue a ruling or determination letter, the request will not be forwarded to the National Office. The Key District Office will let the taxpayer know that the Service will not issue a ruling or a determination letter on the issue. See section 7.01 of this revenue procedure.

SEC. 11. REFERRAL OF MATTERS TO KEY DISTRICT OFFICES

Requests for rulings received by the National Office that, under section 5 of this revenue procedure, may not be acted upon by the National Office may be forwarded to the Key District Office that has examination jurisdiction over the taxpayer's return. If the ruling is forwarded, the taxpayer will be notified of this action. If the request is on an issue or in an area of the type discussed in section 7.01 and it is decided not to issue a ruling or an information letter, the National Office will let the taxpayer know and the request will then be forwarded to the appropriate Key District Office for association with the related return.

SEC. 12. REVIEW OF DETERMINATION LETTERS

.01 Determination letters issued under section 6.01 are generally not reviewed by the National Office before they are issued. If a taxpayer believes that a determination letter of this type is in error, the taxpayer may ask the Key District Director to reconsider the matter. The taxpayer may also ask the Key District Director to request technical advice from the National Office. In such an event the procedures in Rev. Proc. 90-5 must be followed.

.02 The procedures for review of determination letters relating to the qualification of employers' plans involving sections 401 and 403(a) of the Code are provided in Rev. Proc. 80-30.

.03 The procedures for review of determination letters relating to the exemption from federal income tax of certain organizations under sections 501 and 521 of the Code are provided in Rev. Proc. 84-46.

SEC. 13. WITHDRAWAL OR SUSPENSION OF REQUESTS

.01 A request for a ruling or determination letter may be withdrawn at any time before the signing of the letter of reply. If a request for a ruling is withdrawn, the National Office may give its views on the subject matter of the request to the Key District Director whose office will have examination jurisdiction over the taxpayer's return for consideration in connection with any later examination of the taxpayer's return. Even though a request is withdrawn, all correspondence and exhibits will be kept by the Service and will not be returned to the taxpayer. In appropriate cases, the Service may publish its findings in a revenue ruling or revenue procedure.

.02 A request for a ruling will not be suspended in the National Office at the request of a taxpayer.

SEC. 14. ORAL ADVICE TO TAXPAYERS

.01 The Service does not issue rulings or determination letters on oral requests. However, personnel in the Divisions ordinarily will discuss with taxpayers or their representatives inquiries regarding: substantive tax issues; whether the Service will rule on particular issues; and questions relating to procedural matters about submitting ruling requests (including the application of section 8 of this revenue procedure, to a particular case). Any discussion of substantive issues will be at the discretion of the Service on a time available basis, will not be binding on the Service, and cannot be relied upon for purposes of obtaining retroactive relief under the provisions of section 7805(b) of the Code.

.02 A taxpayer may seek oral technical assistance from a taxpayer service representative in a Key District Office or Service Center when preparing a return or report, under other established procedures. Oral advice is advisory only, and the Service is not bound to recognize it in the examination of the taxpayer's return.

.03 Taxpayer service personnel will provide the answers to questions on procedural matters such as the application of the provisions of section 8 above, and questions relating to filing requirements, to obtaining plan determinations, or recognition of exempt status. Taxpayer Service will also answer substantive questions on individual retirement savings arrangements, rollovers, and the taxability of pension distributions.

SEC. 15. EFFECT OF RULINGS

.01 A taxpayer may not rely on a ruling issued to another taxpayer. A ruling, except to the extent incorporated in a closing agreement, may be revoked or modified at any time under appropriate circumstances. See section 4.10 for the effect of a closing agreement. If a ruling is revoked or modified, the revocation or modification applies to all years open under the statutes, unless the Commissioner or the Commissioner's delegate exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the revocation or modification. The manner in which the authority generally is exercised is given later in this section.

.02 When determining a taxpayer's liability, the Key District Director must ascertain whether (1) any ruling previously issued to the taxpayer has been properly applied, (2) the representations upon which the ruling was based reflected an accurate statement of the material facts, and (3) the transaction actually was carried out substantially as proposed. If, in the course of determining the tax liability, the Key District Director finds that a ruling should be modified or revoked, the findings and recommendations of the Key District Director will be forwarded to the National Office for consideration before further action. Such a referral to the National Office will be treated as a request for technical advice and the procedures of Rev. Proc. 90-5 will be followed. Otherwise, the ruling is to be applied by the Key District Office in its determination of the taxpayer's liability.

.03 Appropriate coordination with the National Office will be undertaken if any field official having jurisdiction over a return or other matter proposes to reach a conclusion contrary to a ruling previously issued to the taxpayer.

.04 Except to the extent incorporated in a closing agreement, a ruling found to be in error or not in accord with the current views of the Service may be modified or revoked. Modification or revocation of a ruling may be made by (1) a notice to the taxpayer to whom the ruling was issued, (2) an enactment of legislation or ratification of a tax treaty, (3) a decision of the United States Supreme Court, (4) the issuing of temporary or final

regulations, or (5) the issuing of a revenue ruling, a revenue procedure, or other statement published in the Internal Revenue Bulletin. Consistent with these provisions, if a ruling relates to a continuing action or a series of actions, the ruling will ordinarily be applied until any one of the actions described above has taken place, or until specifically withdrawn. Publication of a notice of proposed rulemaking will not affect the application of any ruling issued under the procedures stated in this revenue procedure.

.05 Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively to the taxpayer for whom the ruling was issued or to a taxpayer whose tax liability was directly involved in the ruling if (1) there has been no misstatement or omission of material facts, (2) the facts at the time of the transaction are not materially different from the facts on which the ruling was based, (3) there has been no change in the applicable law, (4) the ruling was originally issued with respect to a prospective or proposed transaction, and (5) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to the taxpayer's detriment. To illustrate, the tax liability of each employee covered by a ruling relating to a pension plan of an employer is directly involved in such ruling. However, the tax liability of members of an industry is not directly involved in a ruling issued to one of the members, and the holding in a revocation or modification of a ruling to one member of an industry may be retroactively applied to other members of that industry. By the same reasoning, a tax practitioner may not obtain the nonretroactive application to one client of a modification or revocation of a ruling previously issued to another client. If a ruling is revoked by letter with retroactive effect, the letter will, except in fraud cases, state the grounds upon which the revocation is being made and the reasons why the revocation is being applied retroactively.

.06 A ruling issued on a particular transaction represents a holding of the Service on that transaction only. Furthermore, except in rare or unusual circumstances, the application of that ruling to the transaction will not be affected by the later issuance of regulations (either temporary or final), if the conditions specified in section 15.05 are met. However, if the ruling is later found to be in error or no longer in accord with the position of the Service, it will not give the taxpayer protection for a like transaction in the same year or later years.

.07 However, if a ruling is issued covering a continuing action or series of actions and it is determined that the ruling was in error or no longer in accord with the position of the Service, the Assistant Commissioner (Employee Plans and Exempt Organizations) ordinarily will limit the retroactivity of the revocation or modification to a date that is not earlier than that on which the ruling is modified or revoked. Consistent with these provisions, if a ruling relates to a continuing series of actions, the ruling will be applied until the date of issuance of applicable regulations or the publication of a revenue ruling holding otherwise, or until specifically withdrawn. Publication of a notice of proposed rulemaking will not affect the application of any ruling issued under the procedures set forth herein. For more discussion of revocation or modification of rulings or determination letters recognizing exemption, see section 14.01 of Rev. Proc. 84-46.

.08 For rulings involving completed transactions other than those described in section 15.07, taxpayers will not be given the protection against retroactive revocation provided in section 15.05, since they will not have entered into the transactions in reliance on the ruling.

SEC. 16. EFFECT OF DETERMINATION LETTERS

.01 A determination letter issued by a Key District Director has the same effect as a ruling issued to a taxpayer under section 15 of this revenue procedure. However, if the Key District Director is of the opinion that a conclusion contrary to that expressed in the determination letter is indicated, the matter need not be referred to the National Office. A Key District Director may not limit the modification or revocation of a determination letter but may refer the matter to the National Office for the possible exercise by the Commissioner or the Commissioner's delegate of the authority to limit the modification or revocation.

.02 In this connection see also Rev. Procs. 80-30 and 84-46.

SEC. 17. EFFECT OF INFORMATION LETTERS

An information letter issued by the National Office or by a Key District Director is advisory only and the provisions of sections 15 and 16 do not apply.

SEC. 18. PROCEDURE FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF RULINGS AND DETERMINATION LETTERS

.01 Pursuant to section 7805(b) of the Code, it is within the discretion of the Commissioner or the Commissioner's delegate to prescribe the extent, if any, to which any ruling (including determination letters) will be applied without retroactive effect.

A taxpayer to whom a ruling or determination letter has been issued may request that the Assistant Commissioner (Employee Plans and Exempt Organizations), the Commissioner's delegate, exercise the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of any subsequent revocation or modification of the ruling or determination letter.

.02 In the case of a ruling, a request to limit the retroactive effect of the revocation or modification of a ruling must be in the form of, and meet the requirements for, a ruling request generally. These requirements are set forth in section 8 of this revenue procedure. Specifically, the request must state that it is being made pursuant to section 7805(b), contain a statement of the relief sought and an explanation of the reasons and arguments in support of the relief requested, and also be accompanied by any documents bearing on the request. The explanation of the reasons and arguments in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 15.05 of this revenue procedure as they relate to the taxpayer's particular situation.

A request for the application of section 7805(b) of the Code may take the form of a separate request for a ruling when, for example, a revenue

ruling has the effect of modifying or revoking a ruling previously issued to the taxpayer or when the Service notifies the taxpayer of a change in position that will have the effect of revoking or modifying such a ruling. However, when such notice is given by the Key District Director during the course of an examination of the taxpayer's return, or during consideration by the Chief, Appeals Office, a request to limit the retroactive effect of the modification or revocation of a ruling must be made in the form of a request for technical advice. See section 6 of Rev. Proc. 90-5. When germane to a pending ruling request, a request for the application of section 7805(b) may be made as part of the request, either initially or at any time before the ruling is issued. When a ruling that concerns a continuing transaction is modified or revoked by, for example, a subsequent revenue ruling, a request to limit the retroactive effect of the modification or revocation of the ruling must be made before the return is examined that contains the transaction that is the subject of the request for a ruling.

.03 When a request for the application of section 7805(b) of the Code is made in a separate ruling request, the taxpayer has the right to a conference in the National Office in accordance with the provisions of section 9 of this revenue procedure. If the request is made initially as part of a pending ruling request or is made before the conference of right is held on the substantive issues, the section 7805(b) issue will be discussed at the taxpayer's one conference of right. (See section 9.02 of this revenue procedure.) If the request for the application of section 7805(b) is made as part of a pending ruling request after a conference has been held on the substantive issue, and the Service determines that there is justification for having delayed the request, then the taxpayer will have the right to one conference of right concerning the application of section 7805(b) with the conference limited to discussion of this issue.

.04 In the case of a determination letter that the Key District Director proposes to modify or revoke, a request to limit the modification or revocation of the determination letter must be made by requesting the Key District Director who issued the determination letter to seek technical advice from the National Office, since a Key District Director has not been delegated authority under section 7805(b) of the Code to limit the modification or revocation of a determination letter. See section 13.03 of Rev. Proc. 90-5. The taxpayer's request must state that it is being made pursuant to section 7805(b), contain a statement of the relief sought and an explanation of the reasons and arguments in support of the relief requested, and also be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 15.05 of this revenue procedure as they relate to the taxpayer's particular situation.

.05 When technical advice is requested with respect to the application of section 7805(b) of the Code under the circumstances set forth in section 18.04 above, the taxpayer has a right to a conference in the National Office to the same extent as does any taxpayer who is the subject of a technical advice request. See section 13.05 of Rev. Proc. 90-5.

SEC. 19. EFFECT ON OTHER DOCUMENTS

.01 Rev. Procs. 83-36 and 87-40 are superseded.

.02 Rev. Proc. 89-35, 1989-1 C.B. 917, regarding taxpayer requests concerning the return of employer contributions that are not deductible under section 404 of the Code, is modified so that references to Rev. Proc. 83-36 are references to Rev. Proc. 90-4.

SEC. 20. EFFECTIVE DATE

This revenue procedure is effective January 8, 1990, the date of its publication in the Internal Revenue Bulletin.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 90-5

CONTENTS

SECTION 1. PURPOSE
SECTION 2. SCOPE
SECTION 3. CHANGES
SECTION 4. DEFINITIONS AND NATURE OF TECHNICAL ADVICE
SECTION 5. AREAS IN WHICH TECHNICAL ADVICE MAY OR MUST BE REQUESTED
SECTION 6. REQUESTING TECHNICAL ADVICE
SECTION 7. APPEAL BY TAXPAYERS OF DISTRICT OR APPEALS OFFICE DETERMINATION NOT TO SEEK TECHNICAL ADVICE
SECTION 8. WITHDRAWAL OF REQUESTS
SECTION 9. CONFERENCES IN THE NATIONAL OFFICE
SECTION 10. PREPARATION OF TECHNICAL ADVICE MEMORANDUM BY THE NATIONAL OFFICE
SECTION 11. ACTION ON TECHNICAL ADVICE IN DISTRICT AND APPEALS OFFICES
SECTION 12. EFFECT OF TECHNICAL ADVICE
SECTION 13. PROCEDURES FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF TECHNICAL ADVICE
SECTION 14. EFFECT ON OTHER DOCUMENTS

SECTION 1. PURPOSE

The purpose of this revenue procedure is to update Rev. Proc. 80-26, 1980-1 C.B. 671, as modified by Rev. Proc. 83-41, 1983-1 C.B. 775, which provides procedures for furnishing technical advice to Key District Directors and Chiefs, Appeals Office, by the Assistant Commissioner (Employee Plans and Exempt Organizations) regarding issues in the employee plans areas (including actuarial matters) and exempt organizations areas. It also tells taxpayers about their rights when a Key District Director or a Chief, Appeals Office, requests such advice.

SEC. 2. SCOPE

.01 The Commissioner through his delegate, the Assistant Commissioner (Employee Plans and Exempt Organizations), provides principles and rules for uniformly interpreting and applying the federal tax laws under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations).

.02 In the Office of the Assistant Commissioner (Employee Plans and Exempt Organizations), the authority to issue technical advice has been

largely redelegated to the Chiefs of the Employee Plans Rulings Branch, Employee Plans Qualifications Branch, Employee Plans Projects Branch, Pension Actuarial Branch, General Actuarial Branch, and Exempt Organizations Rulings Branches.

.03 This procedure applies to technical advice for employee plans and exempt organizations and is followed in obtaining technical advice on the exemption of farmers' cooperatives from tax under section 521 of the Code, even though the Associate Chief Counsel (Technical) has jurisdiction for issuing technical advice under that section.

.04 Rev. Proc. 90-2, page 386, this Bulletin, provides revised procedures for issuing technical advice in areas under the jurisdiction of the Associate Chief Counsel (Technical). The procedures for obtaining technical advice on specific issues involving the interpretation or application of the federal income tax laws and income tax treaties relating to international transactions are not contained in that revenue procedure but are contained in Rev. Proc. 87-5, 1987-1 C.B. 535.

.05 Technical advice procedures regarding excise taxes (other than the excise taxes imposed under Chapters 41, 42, and 43 of the Internal Revenue Code), and employment taxes that employee plans and exempt organizations may be subject to, are set forth in Rev. Proc. 90-2, page 386, this Bulletin.

SEC. 3. CHANGES

.01 The procedures of this revenue procedure are similar to the procedures of Rev. Proc. 90-2, page 386, this Bulletin, which provides the procedures for technical advice requests under the jurisdiction of the Associate Chief Counsel (Technical). However, this procedure varies from Rev. Proc. 90-2 where employee plans and exempt organizations considerations so require.

.02 The significant areas of change from Rev. Proc. 80-26 are:

(1) Section 3 of Rev. Proc. 80-26 has been redesignated as section 5 and sets forth areas of mandatory technical advice.

(2) Section 5.04 of Rev. Proc. 80-26 has been redesignated as section 7.04 and increases the time frame from 30 to 45 days for National Office review of the taxpayer's appeal to a Key District or Appeals Office's decision not to request technical advice.

(3) Section 6.07 of Rev. Proc. 80-26 has been redesignated as section 9.09 and contains an expanded list of telephone numbers of those Service officials who may be asked the status of a technical advice request.

(4) Section 8 of Rev. Proc. 80-26 has been redesigned as section 10 and has been revised to specifically provide for telephone conferences.

SEC. 4. DEFINITIONS AND NATURE OF TECHNICAL ADVICE

.01 For purposes of this revenue procedure, the word "taxpayer" includes all persons subject to any provision of the Internal Revenue Code and, when appropriate, their representatives.

.02 Any reference to the National Office means only the Office of the Assistant Commissioner (Employee Plans and Exempt Organizations).

.03 Any reference to Key District Director or District Office includes the office of the Director of the Foreign Operations District, where appropriate. References to District Office mean Key District Office as set out in Rev. Proc. 80-30, 1980-1 C.B. 685, and Rev. Proc. 84-46, 1984-1 C.B. 541. Any reference to Chief, Appeals Office, includes Associate Chief, Appeals Office.

.04 For purposes of this revenue procedure, any reference to EP/EO will mean Employee Plans and Exempt Organizations.

.05 With regard to requests for technical advice that are subject to the disclosure provisions of section 6110 of the Code, the taxpayer must follow the procedures in section 601.201(n)(9)(iii)(e) of the Statement of Procedural Rules (26 CFR Part 601). For guidance as to which technical advice requests are subject to section 6110, see section 301.6110-1(a) of the Regulations on Procedure and Administration (26 CFR Part 301).

.06 "Technical advice" means advice or guidance furnished by the National Office upon request of a Key District or an Appeals Office in response to any technical or procedural question that develops during any stage of any proceeding on the interpretation and proper application of tax law, tax treaties, regulations, revenue rulings, or other precedents published on employee plans and exempt organizations matters by the National Office to a specific set of facts. Such proceedings include (1) the examination of a taxpayer's return, (2) consideration of a taxpayer's claim for refund or credit, (3) a request for a determination letter, or (4) any other matter involving a specific taxpayer under the jurisdiction of the Chief, EP/EO Division. Technical advice is furnished as a way of helping Service personnel close cases and establish and maintain consistent holdings throughout the Internal Revenue Service. A Key District Director or an Appeals Office may raise an issue in any tax period, even though technical advice may have been asked for and furnished for the same or a similar issue for another tax period. Technical advice does not include memoranda on matters of general technical application furnished to Key District or Appeals Offices when the issues are not raised in connection with a proceeding involving a specific taxpayer.

.07 If a Key District Director, Chief, Appeals Office, or a taxpayer requests technical advice on a determination letter under section 521 of the Code, the procedures under this revenue procedure and Rev. Proc. 84-46, as well as section 601.201(n) of the Statement of Procedural Rules, must be followed.

.08 Only the National Office can revoke a ruling letter. Therefore, if a Key District Director or a Chief, Appeals Office, thinks that a ruling letter previously issued to a taxpayer should be modified or revoked, including a ruling that involves a matter that is the subject of or is otherwise closely related to a criminal or civil fraud investigation or a jeopardy or termination assessment, the procedures in section 6 of this revenue procedure must be followed.

.09 The provisions of this revenue procedure apply only to EP/EO cases under the jurisdiction of a Key District Director or Chief, Appeals Office. Technical advice may be requested on issues considered in a prior Appeals disposition, not based on mutual concessions for the same tax

period of the same taxpayer, if the Appeals Office that had the case concurs in the request. A Key District Director may not request technical advice on an issue if an Appeals Office is currently considering an identical issue of the same taxpayer (or of a related taxpayer within the meaning of section 267 of the Code or a member of an affiliated group of which the taxpayer is also a member within the meaning of section 1504). A case remains under the jurisdiction of the Key District Director even though an Appeals Office has the identical issue under consideration in the case of another taxpayer (not related within the meaning of sections 267 and 1504, respectively) in an entirely different transaction. With respect to the same taxpayer or the same transaction, when the issue is under the jurisdiction of an Appeals Office, and the applicability of more than one kind of tax is dependent upon the resolution of that issue, a Key District Director may not request technical advice on the applicability of any of the taxes involved.

.10 Any determination letter on exempt status or private foundation status issued by a Key District Office on the basis of National Office technical advice may not, thereafter, be appealed to the Appeals Office with regard to those status issues that were the subject of technical advice.

SEC. 5. AREAS IN WHICH TECHNICAL ADVICE MAY OR MUST BE REQUESTED

.01 Technical advice may be requested on any technical or procedural question that develops during the examination of a taxpayer's return, consideration of a taxpayer's claim for refund or credit, or request for a determination letter that does not come within the requirements of section 6.02 of Rev. Proc. 84-46 regarding exemption applications. These procedures are applicable as provided in section 4.

.02 Requests for technical advice are encouraged on any technical or procedural questions arising in connection with any case of the type described in section 4.06 at any stage of the proceedings in the Key District or Appeals Office that cannot be resolved on the basis of law, regulations, or a clearly applicable revenue ruling or other published precedent.

.03 Aside from the exemption application cases covered by the requirements of Rev. Proc. 84-46, Key District and Appeals Offices are required to request technical advice on their exempt organization cases concerning qualification for exemption or foundation status for which there is no published precedent or for which there is reason to believe that nonuniformity exists. Regarding employee plans matters, a request for technical advice is required on cases concerning (1) proposed adverse or proposed revocation letters on collectively bargained plans, (2) plans for which the Service is proposing to issue a revocation letter because of certain fiduciary actions that violate the exclusive benefit rule of section 401(a) of the Code and are subject to Part 4, Subtitle B of Title 1 of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1, 43, (3) amendments to defined contributions plans pursuant to Rev. Proc. 83-41, 1983-1 C.B. 775, as modified by Rev. Proc. 88-5, 1988-1 C.B. 587, in connection with a waiver of the minimum funding standards and a request for a determination letter, or (4) termination/reestablishment and spinoff/termination cases in which the Key District Office proposes that the Implementation Guidelines are not applicable.

SEC. 6. REQUESTING TECHNICAL ADVICE

.01 The Key District Director or Chief, Appeals Office, is responsible for determining whether to request technical advice on any issue being considered. Each request must be submitted through channels and signed by a person who is authorized to sign for the Key District Director or Chief, Appeals Office, and should include, in writing, a statement of applicable law and the arguments submitted by the Key District or Appeals Office in support of its position on the issue or issues. All requests for technical advice from Appeals Offices should be submitted to the Assistant Commissioner (Employee Plans and Exempt Organizations) through the National Director of Appeals, CC:AP:PT. However, while the case is under the jurisdiction of the Key District Director or the Chief, Appeals Office, a taxpayer may request that an issue be referred to the National Office for technical advice. All requests for technical advice should be made at the earliest possible stage of the proceedings. The grounds for a request are that a lack of uniformity exists on the disposition of the issue or that the issue is unusual or complex enough to warrant consideration by the National Office. Taxpayers may also request technical advice when seeking an extension of time fixed by regulations for making an election or application for relief pursuant to section 1.9100-1 of the Income Tax Regulations. See section 6.11 of this revenue procedure. Although taxpayers are encouraged to make written requests setting forth the facts, law, and argument on the issue, and reasons for requesting National Office technical advice, they may make the request orally. If, after considering the taxpayer's request, the EP/EO specialist or Appeals Officer thinks that the circumstances do not warrant referral of the case to the National Office, the EP/EO specialist or Appeals Officer will tell the taxpayer. (See section 7 for taxpayer's appeal rights when an EP/EO specialist or an Appeals Officer declines to request technical advice.)

.02 When technical advice is going to be requested, whether or not on the request of the taxpayer, the taxpayer will be told about it and given a copy of the arguments submitted by the Key District Director or the Chief, Appeals Office, in support of its position on the issue or issues, except as noted in section 6.10. If the EP/EO specialist or the Appeals Officer initiates the action, the Service will give the taxpayer a copy of the statement of the pertinent facts and the questions proposed for submission to the National Office. The request for technical advice should be worded to avoid possible misunderstanding in the National Office of the facts or the specific points at issue.

.03 If the Service initiates the request for technical advice, the taxpayer has 10 calendar days after receiving the statement of facts and specific questions to indicate in writing any disagreement about them. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, EP/EO Divi-

sion, or the Chief, Appeals Office. Every effort should be made to reach agreement on the facts and the specific points at issue. If agreement cannot be reached, the taxpayer may send, within 10 calendar days after receipt of notice, a statement of the taxpayer's understanding of the new specific points at issue. This statement will be forwarded to the National Office with the request for technical advice. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, EP/EO Division, or the Chief, Appeals Office. When the Key District Director or the Chief, Appeals Office, and the taxpayer cannot agree on material facts, the National Office, at its discretion, may refuse to provide technical advice.

.04 If the taxpayer initiates the action to request technical advice and the taxpayer's statement of the facts and point at issue is not wholly acceptable to the Key District or Appeals Office, the Service will tell the taxpayer in writing what the areas of disagreement are. The taxpayer has 10 calendar days after receiving the written notice to reply to it. The taxpayer must justify in writing an extension beyond the 10 calendar days. The justification must be approved by the Chief, EP/EO Division, or Chief, Appeals Office. If agreement cannot be reached, both the statements of the taxpayer and the Key District or Appeals Office will be forwarded to the National Office with the request for technical advice. When the disagreement involves material facts essential to the preliminary assessment of the case, the Key District Director or Chief, Appeals Office, may, at its discretion, refuse referral to the National Office of a taxpayer initiated request for technical advice or, alternatively, the National Office may refuse to provide technical advice.

.05 If it has not already been done, the taxpayer may submit a statement explaining the taxpayer's position on the issues and citing precedents that the taxpayer believes will bear on the case. This statement will be forwarded to the National Office with the request for technical advice. If the taxpayer's statement is received after the request for technical advice has been forwarded to the National Office, it will be forwarded there to be associated with the request for technical advice. The taxpayer is encouraged to comment on any legislation, tax treaties, regulations, revenue rulings, revenue procedures, or court decisions contrary to the taxpayer's position.

.06 At the time the taxpayer is told that the matter is being referred to the National Office, the taxpayer will also be told about the right to a conference in the National Office if an adverse decision is indicated and will be asked to say whether such a conference is desired.

.07 In connection with requests for technical advice, the taxpayer also has the same 10 days as in sections 6.03 and 6.04 to submit the statement described in section 6.09 of proposed deletions under section 6110(c) of the Code. If the taxpayer does not submit the statement, the Key District Director or the Chief, Appeals Office, will tell the taxpayer that such a statement is required. If the Key District Director or the Chief, Appeals Office, does not receive that statement within 10 days after such notification, the Key District Director or the Chief, Appeals Office, may decline to submit the request for technical advice. If the Key District Director or the Chief, Appeals Office, decides to request technical advice in a case in which the taxpayer has not submitted the statement of proposed deletions, the National Office will make those deletions that the Commissioner determines are required by section 6110(c).

.08 The requirements for submitting statements and other material or proposed deletions in technical advice memoranda before public inspection is allowed do not apply to requests for any documents to which section 6104 of the Code applies.

.09 To help the National Office make the deletions required by section 6110(c) of the Code in technical advice memoranda to be made open to public inspection under section 6110(a), a deletions statement must accompany requests. The statement must either state that no information other than names, addresses, and identifying numbers need be deleted, of if more information is proposed to be deleted, the statement must indicate the deletions proposed by the taxpayer. If the latter alternative is chosen, the statement must be made in a separate document, and it must be accompanied by a copy of all statements of facts and supporting documents that are submitted to the National Office under sections 6.03 and 6.04. The material that the taxpayer wants deleted must be shown in brackets. The statement of proposed deletions must show the statutory basis, under section 6110(c), for each proposed deletion. The statement of proposed deletions must not appear or be referred to anywhere in the request for technical advice. If the taxpayer decides to request additional deletions under section 6110(c) before the National Office replies to the request for technical advice, the taxpayer may submit additional statements. The procedures in this paragraph also apply to additional information submitted during consideration of the technical advice request.

.10 The provisions of this section (about referring issues upon the taxpayer's request, telling the taxpayer about the referral of issues, giving the taxpayer a copy of the arguments submitted by the Key District Director or Chief, Appeals Office, in support of its position on the issue or issues, submitting proposed deletions, and granting conferences in the National Office) do not apply to a technical advice memorandum, described in section 6110(g)(5)(A) of the Code, that involves a matter that is the subject of or is otherwise closely related to a jeopardy or termination assessment or a criminal or civil fraud investigation. However, in these cases after all proceedings in the investigations or assessments are complete but before the Commissioner mails the notice under section 6110(f)(1), of intention to disclose the technical advice memorandum, a copy of the technical advice memorandum will be furnished to the taxpayer and the taxpayer may provide the statement of proposed deletions to the National Office.

.11 See Rev. Proc. 79-63, 1979-2 C.B. 578, which concerns applications for extension of time for making an election or application for relief pursuant to section 1.9100-1 of the Income Tax Regulations. If a taxpayer

requests an extension of time under section 1.9100-1 during an examination or when being considered by an Appeals Office, the procedures of this revenue procedure are applicable, except for section 7. The EP/EO specialist or Appeals Officer is not authorized to deny consideration of a request for technical advice that involves section 1.9100-1 relief. All such requests must be referred to the National Office.

.12 Form 5565, Request for Technical Advice—EP/EO, should be used for transmitting requests for technical advice to the National Office.

.13 Any authorized representative, as described in section 8.13 of Rev. Proc. 90-4, whether or not enrolled to practice, must comply with the conference and practice requirements of the Statement of Procedural Rules (26 CFR 601). Form 2848, Power of Attorney and Declaration of Representative, and Form 2848-D, Tax Information Authorization and Declaration of Representative, may be used with regard to requests for technical advice under this revenue procedure.

SEC. 7. APPEAL BY TAXPAYERS OF DISTRICT OR APPEALS OFFICE DETERMINATION NOT TO SEEK TECHNICAL ADVICE

.01 If the EP/EO specialist or Appeals Officer thinks that a taxpayer's request for referral of an issue to the National Office for technical advice does not warrant referral, the EP/EO specialist or Appeals Officer will tell the taxpayer.

.02 The taxpayer may appeal the decision of the EP/EO specialist or the Appeals Officer not to request technical advice by submitting to that official, within 10 calendar days after being told of the decision, a statement of the facts, law, and arguments on the issue, and the reasons why the taxpayer believes the matter should be referred to the National Office for technical advice. The taxpayer must justify in writing a request for an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, EP/EO Division, or the Chief, Appeals Office.

.03 The EP/EO specialist or the Appeals Officer submits the taxpayer's statement through channels to the Chief, EP/EO Division, or the Chief, Appeals Office, along with the EP/EO specialist's or the Appeals Officer's statement of why the issue should not be referred to the National Office. The Chief determines, on the basis of the statements, whether technical advice will be requested. If the Chief determines that technical advice is not warranted and proposes to deny the request, the taxpayer is told in writing about the determination. In the letter to the taxpayer, the Chief states the reasons for the proposed denial (except in unusual situations when doing so would be prejudicial to the best interests of the Government). The taxpayer has 10 calendar days after receiving the letter to notify the Chief of agreement or disagreement with the proposed denial. The taxpayer may not appeal the decision of the Chief, EP/EO Division, or the Chief, Appeals Office, not to request technical advice from the National Office. However, if the taxpayer does not agree with the proposed denial, all data on the issue for which technical advice has been sought, including the taxpayer's written request and statements, will be submitted to the National Office, Attention: Director, Employee Plans Technical and Actuarial Division, or Director, Exempt Organizations Technical Division, as appropriate. If either Director thinks the circumstances warrant it, he or she may consult the Associate Chief Counsel (Technical) or his or her representatives. After this review, the Key District Office or the Appeals Office is notified whether the proposed denial is approved or disapproved, and, in turn, the Key District Office or the Appeals Office will notify the taxpayer.

.04 While the matter is being reviewed, the Key District Office or the Appeals Office suspends action on the issue (except when the delay would prejudice the Government's interest) until it is notified that the proposed denial is approved or disapproved. This notification is made within 45 calendar days after receipt of the data. The review is solely on the basis of the written record and no conference is held on the matter.

SEC. 8. WITHDRAWAL OF REQUESTS

.01 Only a Key District Director or Chief, Appeals Office, may withdraw a request for technical advice, even a request initiated by the taxpayer. The withdrawal request may be made at any time before the responding transmittal memorandum is signed. The Key District Director or Chief, Appeals Office, must notify the taxpayer in writing of an intent to withdraw the request for technical advice except (1) when the period of limitation on assessment is about to expire and the taxpayer has declined to sign a consent to extend the period, or (2) when such notification would be prejudicial to the best interests of the Government. If the taxpayer does not agree that the request for technical advice should be withdrawn, the procedure in section 7 of this revenue procedure must be followed.

.02 When a request for technical advice is withdrawn, the National Office may send its views to the Key District Director or the Chief, Appeals Office, when acknowledging the withdrawal request. In an Appeals case, acknowledgment of the withdrawal request should be sent to the appropriate Appeals Office, through the National Director of Appeals, CC:AP. In appropriate cases, the subject matter may be published as a revenue ruling or as a revenue procedure.

SEC. 9. CONFERENCES IN THE NATIONAL OFFICE

.01 If after an analysis of the technical advice request it appears that advice adverse to the taxpayer will be given, and if a conference has been requested, the taxpayer will be told, by telephone if possible, the time and place of the conference. The conference must be held within 21 calendar days after such contact has been made. Telephone conferences may be held at a time mutually agreeable to both parties within the 21-day period. If conferences are being arranged for more than one request for technical advice for the same taxpayer, they will be scheduled to cause the least inconvenience to the taxpayer. An extension of the 21-day period will be granted where the taxpayer justifies it in writing and the appropriate Branch Chief or his or her delegate approves it. Because the purpose of these procedures is to facilitate the technical advice process, requests for extensions should be justified by compelling facts and circumstances. The request for extension

should be submitted before the end of the 21-day period. If unusual circumstances near the end of the 21-day period make a written request impractical, within the 21-day period the National Office should be told orally about the problem and of the forthcoming written request for extension. These requests must be promptly submitted. The taxpayer or taxpayer's representative will be told promptly and later in writing of the approval or denial of the requested extension. There is no right to appeal the denial of an extension request. If it is not advised of problems with meeting the 21-day period, or if the request is not sent promptly after the National Office is notified of problems with meeting the 21-day period, the Service will process the case on the basis of the existing record.

.02 A taxpayer is entitled by right to only one conference in the National Office unless one of the circumstances discussed in this section exists. This conference is normally held at the Branch level in the appropriate division (Employee Plans Technical and Actuarial Division or Exempt Organizations Technical Division). It is attended by a person who has authority to sign the transmittal memorandum discussed in section 10.10 on behalf of the Branch Chief. In appropriate cases, the EP/EO Specialist or the Appeals Officer may also attend the conference to clarify the facts in the case. If more than one subject is discussed at the conference, the discussion constitutes a conference for each subject. To promote a free and open discussion of the issues, the conference usually is held after the Branch has an opportunity to study the case. However, the taxpayer may request that the conference of right be held at a stage earlier in the consideration of the case than the Service would ordinarily designate. The taxpayer has no right to appeal the action of a Branch to a Division Director or to any other official of the Service.

.03 In order to issue technical advice memoranda in a more efficient manner, the Branch representatives may offer the taxpayer an option of delaying the conference in order to submit a brief requesting section 7805(b) relief, discussed in section 13 of this revenue procedure, in the event of a final adverse determination by the Service. In such cases, a conference on the tentatively adverse position and the section 7805(b) relief request normally will be scheduled within 10 days of receipt of the taxpayer's section 7805(b) request.

.04 Because conference procedures are informal, no tape, stenographic, or other verbatim recording of a conference is made.

.05 The senior Service representative at the conference ensures that the taxpayer has full opportunity to present views on all the issues in question. The Service representatives explain the Service's tentative decision on the substantive issues and the reasons for it. If prospective application under section 7805(b) of the Code is advanced by the taxpayer, the Service representative will discuss the tentative recommendation concerning the request for relief and the reason for the tentative recommendation. No commitment will be made as to the conclusion that the Service will finally adopt.

.06 An invitation to an additional conference is made if, after the conference of right, an adverse holding is proposed either (1) on a new issue, or (2) on the same issue but on grounds different from those discussed at the first conference. When a proposed holding is reversed at a higher level with a result less favorable to the taxpayer, the taxpayer has no right to another conference if the grounds or arguments on which the reversal is based were discussed at the conference of right. The limitation on the number of conferences to which a taxpayer is entitled does not prevent inviting a taxpayer to attend further conferences when National Office personnel think they are necessary. These additional conferences are held only at the invitation of the National Office.

.07 The taxpayer is responsible for furnishing in writing to the National Office within 21 calendar days after the conference any additional data, lines of reasoning, precedents, etc., that the taxpayer proposed and that were discussed at the conference but not previously or adequately presented in writing. A copy of the additional material submitted by the taxpayer must be sent by the taxpayer to the Key District Director or the Chief, Appeals Office, for comment. If the additional information is not received within 21 days, or other agreed-upon period, the technical advice memorandum will be issued on the basis of the existing record. An extension of the 21-day period may be granted if the taxpayer justifies it in writing and the appropriate Branch Chief to whom the case is assigned approves it. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those in section 9.01. Any additional material should be submitted in duplicate to the National Office. If the additional information would have a significant impact on the facts in the request for technical advice, the National Office must send a copy to the Key District Director or the Chief, Appeals Office, for comment on the facts contained in the additional information submitted. The Key District Director or the Chief, Appeals Office, gives the matter prompt attention.

.08 A taxpayer may get information on the status of the request for technical advice by contacting the Key District or Appeals Office that requested the technical advice.

.09 A Key District Director or a Chief, Appeals Office, as well as a taxpayer, may get current information on the status of the request for technical advice by calling the office of the appropriate Branch Chief. The offices and their matters of responsibility are listed below:

Official	Telephone Numbers (Area Code 202) (not toll free)
Chief, Employee Plans Rulings Branch	566-4501
Chief, Employee Plans Qualifications Branch	566-3672

Official	Telephone Numbers (Area Code 202) (not toll free)
Chief, Employee Plans Projects Branch	566–3065
Chief, Pension Actuarial Branch	535–6768
Chief, General Actuarial Branch	566–4316
Chief, Exempt Organizations Rulings Branches	566–3856 or 566–4451

SEC. 10. PREPARATION OF TECHNICAL ADVICE MEMORANDUM BY THE NATIONAL OFFICE

.01 Requests for technical advice generally are given priority and processed expeditiously. As soon as the request for technical advice is assigned, the tax law specialist analyzes the file to see whether it meets all requirements of section 6. If it does not comply with the requirements of section 6.09, relating to the statement of proposed deletions, the National Office makes the deletions from the technical advice memorandum that the Commissioner determines are required by section 6110(c) of the Code.

.02 If the taxpayer has requested a conference in the National Office, the procedures in section 9 will be followed.

.03 Usually, upon initial review within 21 calendar days after the Branch Office receives the request for technical advice, or if a request for technical advice is incomplete, a representative of the Branch telephones the Key District or Appeals Office to discuss the procedural and substantive problems in the request that come within the Branch's jurisdiction. The Branch representative informs the Key District or Appeals Office:

(1) that the case is being returned because substantial additional information is required to resolve an issue, because significant unresolved factual variances exist between the statement of facts submitted by the Key District or Appeals Office and the taxpayer, or because major procedural problems cannot be resolved by phone (A request for technical advice will not be returned or reply delayed merely because additional information not essential to the preliminary assessment of the case is needed.); or

(2) that the case is not being returned but more information is needed or minor procedural deficiencies exist.

.04 After the Branch receives the additional information requested in section 10.03(2), the Branch representative may telephone the Key District or Appeals Office to discuss the procedural and substantive issues in the request that come within the jurisdiction of the Branch.

.05 A tentative conclusion may be discussed with the Key District or Appeals Office. But, because the Branch representative's tentative conclusion may change during the preparation and review of the technical advice memorandum, it is not, under any circumstances, considered final. The Key District or Appeals Office may not tell the taxpayer what the tentative conclusion is.

.06 When the technical advice request concerns matters within the jurisdiction of more than one Division, a representative of the Division that received the original technical advice request informs the Key District or Appeals Office as soon as possible: (1) that the matters within the jurisdiction of another Division have been referred to the other Division or office for consideration, and (2) that a representative of the other Division may contact the Key District or Appeals Office about the technical advice request.

.07 If during the analysis and development of the case it is determined after discussion with the appropriate Branch Chief or reviewer, that additional information essential to the preliminary assessment of the case is needed, a Branch representative will obtain the additional information in the most expeditious manner possible from the taxpayer or the Key District Director or Chief, Appeals Office. Any additional information requested from the taxpayer by the National Office must be submitted by letter appended by a penalties of perjury statement within 21 calendar days or other agreed-upon period, after the request for information is made. Section 8.13 of Rev. Proc. 90–4 sets out the requirements as to who can sign documents supplying information to the Service. A written request for an extension of time to submit additional material must be received by the National Office within the 21-day period, setting forth compelling facts and circumstances justifying the proposed extension. The Branch Chief to whom the case is assigned will determine whether to grant or deny the request for an extension of the 21-day period. There is no right to appeal the denial of an extension request. If the National Office does not receive the submission within the period of 21 days, plus any extensions granted by the Branch Chief, the National Office will issue the technical advice memorandum based on the existing record.

.08 Any additional information submitted by the taxpayer should be sent to the National Office and a copy sent to either the Key District Director or the Chief, Appeals office, for comments on the additional information. If the Key District Director or Chief, Appeals Office, has comments, they must be furnished promptly to the appropriate Branch in the National Office that has jurisdiction over the case.

.09 Generally, before replying to the request for technical advice, the National Office informs the taxpayer orally or in writing of the material likely to appear in the technical advice memorandum that the taxpayer proposed be deleted but that the Service determined should not be deleted. If so informed, the taxpayer may submit within 10 calendar days any further information, arguments, or other material that should be deleted. The Service attempts, if possible, to resolve all disagreements about proposed deletions before the National Office replies to the request for technical advice. However, the taxpayer does not have the right to a conference to resolve any disagreements about material to be deleted from the

text of the technical advice memorandum. These matters, however, may be considered at any conference otherwise scheduled for the technical advice request.

.10 Replies to requests for technical advice are addressed to the Key District Director or the Chief, Appeals Office. When a request for technical advice is from Appeals, the response to the appropriate Appeals Office will be routed through the National Director of Appeals, CC:AP. The replies to technical advice requests are in two parts. Each part identifies the taxpayer by name, address, tax identification number, and year or years involved. The first part of the reply is a transmittal memorandum. In unusual cases it is a way of giving the District or Appeals Office administrative information or other information that under the nondisclosure statutes or for other reasons, may not be discussed with the taxpayer. The second part (the "technical advice memorandum") contains: (1) a statement of the issues; (2) a statement of the pertinent facts in the issues; (3) a statement of the pertinent law, tax treaties, regulations, revenue rulings and other precedents published in the Internal Revenue Bulletin, and court decisions; (4) a discussion of the rationale developed by the National Office; and (5) the conclusions of the National Office. The conclusions give direct answers, whenever possible, to the specific questions of the Key District or Appeals Office. The discussion of the issues is in enough detail so the Key District or Appeals officials know the reasoning underlying the conclusion. Where applicable, accompanying the technical advice memorandum is a notice, under section 6110(f)(1) of the Code, of intention to disclose a technical advice memorandum (including a copy of the version proposed to be open to public inspection and notations of third party communications under section 6110(d)). The District Director of a Key District Office or the Chief, Appeals Office, forwards this notice to the taxpayer when the District Director of a Key District Office or the Chief, Appeals Office, gives a copy of the technical advice memorandum to the taxpayer according to section 10.09.

.11 A copy of the technical advice memorandum will be given to the taxpayer only after it has been adopted by the District Director of a Key District Office or the Chief, Appeals Office. However, in the case of technical advice memoranda described in section 6110(g)(5)(A) of the Code, relating to cases involving criminal or civil fraud investigations and jeopardy or termination assessments, a copy of the technical advice memorandum is not given to the taxpayer until all proceedings in the investigations or assessments are completed.

.12 After receiving the notice under section 6110(f)(1) of the Code of intention to disclose the technical advice memorandum, the taxpayer may protest the disclosure of certain information in it. The taxpayer must submit a written statement within 20 calendar days identifying those deletions not made by the Service that the taxpayer believes should have been made. The taxpayer must also submit a copy of the version of the technical advice memorandum proposed to be open to public inspection with brackets around deletions that are proposed by the taxpayer but that have not been made by the National Office. Generally, the National Office does not consider the deletion of any material that the taxpayer has not proposed be deleted before the National Office reply is sent to the request for technical advice to the District Director of a Key District Office or the Chief, Appeals Office. Within 20 days after it receives the taxpayer's response to the notice under section 6110(f)(1), the National Office must mail the taxpayer its final administrative conclusion about the deletions to be made.

SEC. 11. ACTION ON TECHNICAL ADVICE IN DISTRICT AND APPEALS OFFICES

.01 The District Director of a Key District Office or the Chief, Appeals Office, must process the taxpayer's case on the basis of the conclusions in the technical advice memorandum unless (1) the District Director of a Key District Office or the Chief, Appeals Office, thinks that the conclusions reached by the National Office in a technical advice memorandum should be reconsidered, or (2) the Chief, Appeals Office, in the case of technical advice unfavorable to the taxpayer, decides to settle the issue in the usual manner under existing authority.

.02 In any event, with or without requesting reconsideration, the Key District Director must follow the conclusions in a technical advice memorandum as to all issues, and the Chief, Appeals Office, must follow the conclusions in a technical advice memorandum on issues of an organization's/plan's status or qualification. Thus, if the technical advice memorandum received by a Key District Director concerns an organization's/plan's status or qualification, the organization/plan has no appeal to the Appeals Office on those specific issues.

.03 The District Director of a Key District Office or the Chief, Appeals Office, gives the taxpayer (1) a copy of the technical advice memorandum described in section 10.10, and (2) the notice under section 6110(f)(1) of the Code of intention to disclose the technical advice memorandum (including a copy of the version proposed to be open to public inspection and notations of third party communications under section 6110(d)). This requirement does not apply to technical advice memoranda involving civil fraud or criminal investigations; jeopardy or termination assessments, as described in section 6.10; or documents to which section 6104 applies.

.04 In those cases in which the National Office tells the District Director of a Key District Office or the Chief, Appeals Office, that a copy of the technical advice memorandum should not be given to the taxpayer, the District Director or the Chief, Appeals Office, tells this to the taxpayer if the taxpayer requests a copy.

SEC. 12. EFFECT OF TECHNICAL ADVICE

.01 A taxpayer may not rely on a ruling issued to, or a technical advice memorandum received from the Service by, another taxpayer. Except in rare or unusual circumstances, a holding in a technical advice memorandum is applied retroactively. Moreover, where the taxpayer had previously been issued a favorable ruling or determination letter, whether or not it was based on a previous technical advice memorandum concerning the transaction, purpose, or method of operations, the holding in

a technical advice memorandum is applied retroactively unless the Assistant Commissioner (Employee Plans and Exempt Organizations) exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the holding.

.02 As to the effective date in cases involving rulings or determination letters regarding exempt organizations and employee plans (including actuarial matters) see section 15 of Rev. Proc. 90–4, section 12.01 of Rev. Proc. 84–46, and section 13 of Rev. Proc. 80–30.

.03 A holding that modifies or revokes a holding in a prior technical advice memorandum is applied retroactively, with one exception. If the new holding is less favorable to the taxpayer than the earlier one, it generally is not applied to the period in which the taxpayer relied on the prior holding in situations involving continuing transactions.

.04 If a technical advice memorandum relates to a continuing action or a series of actions, it is ordinarily applied until specifically withdrawn or until the conclusion is modified or revoked by enactment of legislation, ratification of a tax treaty, or issuance of a United States Supreme Court decision, regulations (temporary or final), a revenue ruling, or other statement published in the Internal Revenue Bulletin. Publication of a notice of proposed rulemaking does not affect the application of a technical advice memorandum.

.05 Generally, a technical advice memorandum that revokes or modifies a letter ruling or another technical advice memorandum is not applied retroactively for either the taxpayer to whom or for whom the ruling or memorandum was originally issued or for a taxpayer whose tax liability was directly involved in such ruling or memorandum if: (1) there has been no misstatement or omission of material facts; (2) the facts at the time of the transaction are not materially different from the facts on which the ruling or memorandum was based; (3) there has been no change in the applicable law; (4) in the case of a ruling, it was originally issued on a prospective or proposed transaction; and (5) the taxpayer directly involved in the ruling or memorandum acted in good faith in relying on the ruling or memorandum and the retroactive revocation would be to the taxpayer's detriment. For example, the tax liability of each employee covered by a ruling or memorandum relating to a pension plan of an employer is directly involved in such ruling or memorandum. However, the tax liability of members of an industry is not directly involved in a ruling or memorandum issued to one of the members, and the holding in a revocation or modification of a ruling or memorandum to one member of an industry may be retroactively applied to other members of that industry. By the same reasoning, a tax practitioner may not obtain the non-retroactive application to one client of a modification or revocation of a ruling or memorandum previously issued to another client. When a ruling to a taxpayer or a memorandum involving a taxpayer is revoked with retroactive effect, the notice to the taxpayer, except in fraud cases, sets forth the grounds on which the revocation is being made and the reasons why the revocation is being applied retroactively.

SEC. 13. PROCEDURES FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF TECHNICAL ADVICE

.01 Pursuant to section 7805(b) of the Code, it is within the discretion of the Commissioner or the Commissioner's delegate to prescribe the extent, if any, to which any ruling (including technical advice) will be applied without retroactive effect.

A taxpayer who has received a technical advice memorandum or with respect to whom a technical advice request is pending may request that the Assistant Commissioner (Employee Plans and Exempt Organizations), the Commissioner's delegate, exercise the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of any holding stated in the technical advice memorandum or to limit the retroactive effect of any subsequent modification or revocation of the technical advice memorandum.

.02 When a technical advice memorandum that concerns a continuing transaction is modified or revoked by, for example, a subsequent revenue ruling or final regulations, a request to limit the retroactive effect of the modification or revocation of the technical advice memorandum must be made in the form of a request for a ruling when the request is submitted before the return is examined that contains the transaction that is the subject of the request for ruling. See section 18.02 of Rev. Proc. 90–4.

.03 When a taxpayer is informed of the modification or revocation of a technical advice memorandum, ruling letter, or determination letter during the course of an examination of the taxpayer's return by the District Director of a Key District Office or during consideration by the Chief, Appeals Office, a request to limit the retroactive application of the modification or revocation of the technical advice memorandum, ruling letter, or determination letter must itself be made in the form of a request for technical advice. See section 6 of this revenue procedure. However, the taxpayer must also submit a statement, which will be forwarded to the National Office with the request for technical advice, that the request for technical advice is being made pursuant to section 7805(b) of the Code. This statement must also set forth the relief sought and an explanation of the reasons and arguments in support of the relief requested, and it must be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 12.05 of this revenue procedure as they relate to the taxpayer's particular situation. The taxpayer's request for relief pursuant to section 7805(b) is forwarded by the District Director of a Key District Office or the Chief, Appeals Office, to the National Office for consideration.

.04 A request to limit the retroactive effect of a holding in a technical advice memorandum that does not modify or revoke a technical advice memorandum may be made as part of that technical advice request, either initially, or at any time before the technical advice memorandum is issued by the National Office. In such a case, the taxpayer must also submit a statement in support of the application of section 7805(b) of the Code, as described in 13.03 above.

.05 When a request for technical advice concerns only the application of section 7805(b) of the Code, the taxpayer has the right to a conference in the National Office in accordance with the provisions of section 9 of this revenue procedure. If the request for application of section 7805(b) is included in the request for technical advice on the substantive issues or is made before the conference of right on the substantive issues, the section 7805(b) issues will be discussed at the taxpayer's one conference of right. If the request for the application of section 7805(b) is made as part of a pending technical advice request after a conference has been held on the substantive issue, and the Service determines that there is justification for having delayed the request, then the taxpayer will have the right to one conference of right concerning the application of section 7805(b), with the conference limited to discussion of this issue.

SEC. 14. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 80-26, 1980-1 C.B. 671, is superseded.

.02 Rev. Proc. 83-41, 1983-1 C.B. 775 is modified to the extent necessary to conform to this revenue procedure.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 90-6

SECTION 1. PURPOSE AND NATURE OF CHANGES

.01 Purpose.

The purpose of this revenue procedure is to update Rev. Proc. 89-6, 1989-1 C.B. 776, by providing a list of subject matters under the jurisdiction of the Associate Chief Counsel (International) to which the Internal Revenue Service will not issue advance rulings or determination letters. Rev. Proc. 90-3, page 402, this Bulletin, lists the subject matters under the jurisdiction of the Associate Chief Counsel (Technical) in which the Service will not issue advance rulings or determination letters.

.02 Changes.

1. New section 4.015 refers to section 956 of the Code.

2. New section 4.018 refers to section 1058 of the Code.

SEC. 2. BACKGROUND AND SCOPE OF APPLICATION

01. Background.

Whenever appropriate to sound tax administration, the Service answers inquiries from individuals and organizations about their status for tax purposes and the tax effects of their acts or transactions, before the filing of returns or reports that are required by the Internal Revenue Code. There are, however, areas where the Service will not issue advance rulings or determination letters, either because the issues are inherently factual or for other reasons. This revenue procedure lists those areas.

Section 3 gives areas in which advance rulings and determinations will not be issued under any circumstances. Section 4 gives areas in which they will not ordinarily be issued; in these areas, unique and compelling reasons may justify issuing a ruling or determination letter. The Service may provide a general information letter in response to inquiries in areas on either list.

These lists are not all-inclusive. Future revenue procedures may add or delete items. The Service may also decline to rule on an individual case for reasons peculiar to that case; such decisions will not be announced in the bulletin.

02. Scope of Application.

This revenue procedure does not preclude District Directors, the Assistant Commissioner (International), or Appeals Offices from submitting requests for technical advice in the areas listed to the National Office.

SEC. 3. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED

01. Specific Questions and Problems.

1. Section 871(g).—Special Rules for Original Issue Discount.—Whether a debt instrument having original issue discount within the meaning of section 1273 of the Internal Revenue Code of 1986 is not an original issue discount obligation within the meaning of section 871(g)(1)(B)(1) when the instrument is payable 183 days or less from the date of original issue (without regard to the period held by the taxpayer) and the instrument is issued by a domestic corporation and purchased by its controlled foreign corporation.

2. Section 954.—Foreign Base Company Income.—The effective rate of tax that a foreign country will impose on income.

3. Section 7701.—Definitions.—Whether a foreign arrangement that is a participant in a domestic arrangement classified as a partnership for United States tax purposes will itself be classified as a partnership, corporation, or agent.

4. Section 7701.—Definitions.—Whether a foreign limited liability company will be classified as a partnership, if a taxpayer who holds an interest therein seeks the partnership classification and (1) the taxpayer is a corporation and independent parties hold less than 20 percent of the interests in the limited liability company, or (2) the taxpayer is not a corporation and independent parties hold only a nominal interest in the company.

02. General Areas.

1. The prospective application of the estate tax to the property or the estate of a living person, except that rulings may be issued on any international issues in a ruling request accepted pursuant to Rev. Proc. 88-50, 1988-2 C.B. 711, and section 17.02 of Rev. Proc. 90-1, page 356, this Bulletin.

2. The federal tax consequences of proposed federal, state, local, municipal, or foreign legislation.

3. Whether reasonable cause exists under Subtitle F (Procedure and Administration) of the Code.

4. Whether a proposed transaction would subject a taxpayer to criminal penalties.

5. Any area, where the ruling request does not comply with the requirements of Rev. Proc. 87-4, 1987-1 C.B. 33, as modified by Rev. Proc. 88-4, 1988-1 C.B. 586, and modified and amplified by Rev. Proc. 88-8, 1988-1 C.B. 628 (as modified by Rev. Proc. 88-13, 1988-1 C.B. 639, and Rev. Proc. 88-27, 1988-1 C.B. 804), and Rev. Proc. 89-4, 1989-1 C.B. 767.

6. Any area, where the same issue

is the subject of the taxpayer's pending request for competent authority assistance under a United States tax treaty.

SEC. 4. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT ORDINARILY BE ISSUED

01. Specific Questions and Problems.

1. Section 367(a).—Transfers of Property from the United States.—Whether an oil or gas working interest is transferred from the United States for use in the active conduct of a trade or business for purposes of section 367(a)(3) of the Code; and whether any other property is so transferred, where the determination requires extensive factual inquiry.

2. Section 367(b).—Other Transfers.—Whether a foreign corporation is considered a corporation for purposes of any nonrecognition provision listed in section 367(b), and related issues, unless the ruling presents a significant legal issue. (These matters are dealt with in detail in section 7.367(b) of the Temporary Income Tax Regulations.)

3. Section 864.—Definitions and Special Rules.—Whether a taxpayer is engaged in a trade or business within the United States, and whether income is effectively connected with the conduct of a trade or business within the United States; and in particular, whether a taxpayer trading in stocks, securities, or commodities is engaged in a trade or business within the United States under section 1.864-2(c) and (d) of the regulations.

4. Section 882.—Tax on Income of Foreign Corporations Connected with United States Business.—Under section 1.882-5(b) of the regulations, whether a taxpayer using the actual ratio may change to the fixed ratio, and whether a taxpayer electing either the branch book/dollar pool method or the separate currency pools method may change methods.

5. Section 892.—Income of Foreign Governments and of International Organizations.—Whether income received by local governmental authorities of the United Kingdom from certain United States investments of money allocable to their superannuation funds is exempt from federal income taxation.

6. Section 892.—Income of Foreign Governments and of International Organizations.—Whether a foreign government is engaged in commercial activities for purposes of section 892, and whether income received by a foreign government is derived from the conduct of such commercial activities.

7. Section 893.—Compensation of Employees of Foreign Governments and of International Organizations.—Whether a foreign government is engaged in commercial activities for purposes of section 893, and whether the services of an employee of a foreign government are primarily in connection with such commercial activities.

8. Section 894.—Income Affected by Treaty.—Whether a taxpayer has a permanent establishment in the United States for purposes of any United States income tax treaty.

9. Section 894.—Income Affected by Treaty.—Whether the income received by a nonresident alien student for services performed for a university or other educational institution is exempt from federal income tax or withholding under United States income tax treaties with Belgium, China, Cyprus, Egypt, Finland, France, Iceland, Japan, Korea, Morocco, the Netherlands, Norway, Pakistan, the Philippines, Poland, Romania, and Trinidad and Tobago.

10. Section 894.—Income Affected by Treaty.—Whether the income received by a nonresident alien performing research or teaching at a university is exempt from federal income tax or withholding under United States income tax treaties with Belgium, China, Egypt, Finland, France, Hungary, Iceland, Italy, Jamaica, Japan, Korea, Luxembourg, the Netherlands, Norway, the Philippines, Poland, Romania, Sweden, Trinidad and Tobago, the Union of Soviet Socialist Republics, and the United Kingdom.

11. Section 894.—Income Affected by Treaty.—Whether the income received by a nonresident alien teaching at a university is exempt from federal income tax or withholding under United States income tax treaties with Austria, Denmark, the Federal Republic of Germany, Greece, Ireland, Pakistan, and Switzerland.

12. Section 894.—Income Affected by Treaty.—Whether a recipient of any payment is ineligible to receive the benefits of a United States tax treaty under the principles of Rev. Rul. 84-152, 1984-2 C.B. 381, and Rev. Rul. 84-153, 1984-2 C.B. 383.

13. Section 894.—Income Affected by Treaty.—Whether a recipient of payments is or has been a resident of a country for purposes of any United States tax treaty. Pursuant to section 1.884-5T(f) of the temporary regulations, however, the Service will rule whether a corporation representing that it is a resident of a country is a qualified resident thereof for purposes of section 884.

14. Section 901.—Taxes of Foreign Countries and of Possessions of United States.—Whether a person claiming a credit has established, based on all of the relevant facts and circumstances, the amount (if any) paid by a dual capacity taxpayer under a qualifying levy that is not paid in exchange for a specific economic benefit. See section 1.901-2A(c)(2) of the regulations.

15. Section 956.—Investment of Earnings in United States Property.—Whether a pledge of the stock of a controlled foreign corporation is an indirect pledge of the assets of that corporation. See section 1.956-2(c)(2) of the regulations.

16. Section 985.—Functional Currency.—Whether a currency is the functional currency of a qualified business unit.

17. Section 989(a).—Qualified Business Unit.—Whether a unit of the taxpayer's trade or business is a qualified business unit.

18. Section 1058.—Transfers of Securities under Certain Agreements.—Whether the amount of any payment described in section 1058(b)(2) or the amount of any other payment made in connection with a transfer of securities described in section 1058 is from sources within or without the United States; the character of such amounts; and whether the amounts constitute a particular kind of income for purposes of any United States income tax treaty.

19. Section 7701.—Tax on Nonresident Alien Individuals.—Whether an alien individual is either a resident or nonresident of the United States, in situations where the determination de-

pends on facts that cannot be confirmed until the close of the taxable year (including, for example, the length of the alien's stay or the nature of the alien's activities).

20. Section 7701.—Definitions.—Whether a foreign corporation will be classified as a partnership for United States tax purposes, if the taxpayer seeks the partnership status; and whether a foreign partnership will be classified as an association for United States tax purposes, if the taxpayer seeks the association status. Requests for advance rulings about the classification of foreign entities should be submitted according to Rev. Proc. 90-1, page 356, this Bulletin. The Office of the Associate Chief Counsel (Technical) coordinates the response to such requests with the Office of the Associate Chief Counsel (International).

21. Section 7701.—Definitions.—Whether an estate or trust is a foreign estate or trust for federal income tax purposes.

02. General Areas.

Whether a taxpayer has a business purpose for a transaction or arrangement.

SEC. 5. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 89-6 is superseded.

SEC. 6. EFFECTIVE DATE

This revenue procedure applies to all ruling requests on file in the National Office on January 16, 1990, and to all requests received thereafter.

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26 CFR 601.602: Tax forms and instructions. (Also Part 1, Sections 1, 32, 63, 151, 6012, 6013; 1.1-1, 1.43-2, 1.63-1, 1.151-4, 1.6012-1, 1.6013-1.)

Rev. Proc. 90-7

SECTION 1. PURPOSE

This revenue procedure provides the income tax inflation adjustment (indexing) factors as determined pursuant to various provisions of the Internal Revenue Code for taxable years beginning in 1990. The revenue procedure applies the factors to the following: the tax rate tables for individuals and for estates and trusts; the basic standard deduction amounts for different filing statuses; the limitation on the standard deduction in the case of certain dependents; the additional standard deductions for the aged and blind; the earned income credit; and the personal exemption.

SEC. 2. BACKGROUND

.01 Section 1(f)(1) of the Code provides that not later than December 15 of each calendar year, the Secretary shall prescribe inflation-adjusted tax rate tables that shall apply in lieu of the tax rate tables in subsections (a), (b), (c), (d), and (e) of section 1 with respect to taxable years beginning in the succeeding calendar year.

Under section 1(f)(3) of the Code, the inflation adjustment for a calendar year is determined based on the percentage (if any) by which the Consumer Price Index (CPI) for the preceding calendar year exceeds the CPI for the calendar year 1987. For purposes of computing the inflation adjustment, section 1(f)(4) defines the CPI as the average of the 12 monthly CPIs for the 12-month period ending on August 31 of such calendar year. Under section 1(f)(5), the CPI is that for all-urban consumers published by the Department of Labor.

Section 1(f)(2)(A) of the Code provides that the inflation adjustment is reflected in the tax rate tables by increasing the minimum and maximum amounts subject to the 15% and 28% tax brackets. Under section 1(f)(6), an adjusted bracket amount is "rounded down" to the nearest multiple of $50 ($25 for a table for married individuals filing separately).

.02 Under section 63(c)(4) of the Code, the standard deduction amounts (including the limitation for certain dependents and the additional standard deduction for the aged or blind) are adjusted for inflation under the method described in section 1(f)(3). Section 1(f)(6)(A) provides that, in general, an adjusted amount is "rounded down" to the nearest multiple of $50. Section 1(f)(6)(B), as amended by the Revenue Reconciliation Act of 1989 (the Act), Pub. L. No. 101-239, section 7831, 103 Stat. 2106 (1989), provides that the adjusted amount of the basic standard deduction is rounded by $25 in the case of married individuals filing separately.

.03 Section 32(i) of the Code provides that the dollar amounts of the limitations applicable to the earned income credit are adjusted for inflation under the method described in section 1(f)(3) except that the preceding calendar year's CPI shall be compared with the CPI for the calendar year 1984. This adjustment is not subject to the $50 "rounded down" rule described above. Instead, under section 32(i)(3), a dollar amount limitation that is not a multiple of $10 is rounded (not rounded down) to the nearest multiple of $10 (or, if the increase is a multiple of $5, it is increased to the next highest multiple of $10).

.04 Section 151(d)(3) of the Code provides that for taxable years beginning after 1989 the personal exemption amount is adjusted for inflation under the method described in section 1(f)(3) except that the preceding calendar year's CPI shall be compared with the CPI for the calendar year 1988. The adjusted exemption is "rounded down" to the nearest multiple of $50 under section 1(f)(6) as amended by section 7831 of the Act.

SEC. 3. INFLATION ADJUSTMENT FACTORS

.01 Tax rate tables and standard deduction—The CPI for 1989 is 122.1500000000 and the CPI for 1987 is 111.9833333333. Based on these figures, the inflation adjustment factor for the tax rate schedules and standard deductions for taxable years beginning in 1990 is 1.0907873195.

.02 Earned income credit—The CPI for 1989 is 122.1500000000 and the CPI for 1984 is 102.4916666667. Based on these figures, the inflation adjustment for the earned income credit for taxable years beginning in 1990 is 1.1918042117.

.03 Personal exemption—The CPI for 1989 is 122.1500000000 and the CPI for 1988 is 116.6166666667. Based on these figures, the inflation adjustment for the personal exemption for taxable years beginning in 1990 is 1.0474489067.

SEC. 4. ADJUSTED TAX RATE TABLES

.01 The following adjusted tax rate tables are prescribed in lieu of the tables in subsections (a), (b), (c), (d), and (e) of section 1 of the Code with respect to taxable years beginning in 1990.

TABLE 1—Section 1(a).—MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES

If Taxable Income Is:	The Tax Is:
Not Over $32,450	15% of the taxable income
Over $32,450	$4,867.50 plus 28% of the excess over $32,450

TABLE 2—Section 1(b).—HEADS OF HOUSEHOLDS

If Taxable Income Is:	The Tax Is:
Not Over $26,050	15% of the taxable income
Over $26,050	$3,907.50 plus 28% of the excess over $26,050

TABLE 3—Section 1(c).—UNMARRIED INDIVIDUALS (OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS)

If Taxable Income Is:	The Tax Is:
Not Over $19,450	15% of the taxable income
Over $19,450	$2,917.50 plus 28% of the excess over $19,450

TABLE 4—Section 1(d).—MARRIED INDIVIDUALS FILING SEPARATE RETURNS

If Taxable Income Is:	The Tax Is:
Not Over $16,225	15% of the taxable income
Over $16,225	$2,433.75 plus 28% of the excess over $16,225

TABLE 5—Section 1(e).—ESTATES AND TRUSTS

If Taxable Income Is:	The Tax Is:
Not Over $5,450	15% of the taxable income
Over $5,450	$817.50 plus 28% of the excess over $5,450.

.02 The benefit of the 15 percent tax bracket is phased out under section 1(g)(2) of the Code for taxpayers having taxable income exceeding certain levels. The applicable dollar amounts at which that phaseout begins and ends are as follows:

	Begins	*Ends*
Section 1(a)	$78,400	$162,770
Section 1(b)	$67,200	$134,930
Section 1(c)	$47,050	$ 97,620
Section 1(d)	$39,200	$123,570
Section 1(e)	$14,150	$ 28,320

.03 At the point at which the phaseout of the benefit of the 15 percent tax bracket is completed, section 1(g)(2) of the Code further provides for the phaseout of the tax benefit of the personal exemptions allowed by section 151. Thus, the applicable dollar amounts at which that phaseout begins are as follows:

Section 1(a)	$162,770
Section 1(b)	$134,930
Section 1(c)	$ 97,620
Section 1(d)	$123,570
Section 1(e)	-------

The dollar amount at which this phaseout is completed varies according to the number of exemptions claimed.

SEC. 5. ADJUSTED STANDARD DEDUCTION

.01 The following adjusted standard deduction amounts are prescribed in lieu of the amounts set forth in section 63(c)(2) of the Code with respect to taxable years beginning in 1990.

Filing Status	*Standard Deduction*
MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES	$5,450
HEADS OF HOUSEHOLDS	$4,750
UNMARRIED INDIVIDUALS (OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS)	$3,250
MARRIED INDIVIDUAL FILING A SEPARATE RETURN	$2,725

.02 Under section 63(c)(5) of the Code, in the case of an individual with respect to whom a deduction under section 151 is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins, the individual's standard deduction for such individual's taxable year cannot exceed the greater of (A) $500 or (B) the amount of the individual's earned income. The $500 amount is subject to adjustment for inflation. Applying the factor set forth in section 3.01 above to $500 results in a figure of $545.39. Accordingly, due to the $50 "rounding-down" provisions of section 1(f)(6), the $500 amount remains unchanged for taxable years beginning in 1990.

.03 Section 63(f) of the Code provides for an additional standard deduction amount of $600 for the aged and blind. That amount is increased to $750 if the individual is also unmarried and not a surviving spouse. The $600 and $750 amounts are subject to adjustment for inflation. Applying the factor set forth in section 3.01 above to the $600 and $750 figures results in figures of $654.47 and $818.09, respectively. Accordingly, due to the $50 "rounding-down" provisions of section 1(f)(6), the additional standard deduction amount for the aged and blind for tax years beginning in 1990 is $650 and that amount is increased to $800 if the individual is also unmarried and not a surviving spouse.

SEC. 6. ADJUSTED EARNED INCOME CREDIT

.01 Section 32 of the Code provides an "earned income" credit for taxpayers who have dependent children and maintain a household. Generally, "earned income" includes wages, salaries, and other employer compensation, plus earnings from self-employment. Under section 32, the credit is equal to 14 percent of the first $5,714 of earned income. The credit is phased out at a rate of 10 percent of the amount of adjusted gross income (or, if greater, the earned income) that exceeds $9,000. The $5,714 and the $9,000 figures are subject to an inflation adjustment.

.02 As stated in section 3.02 above, for taxable years beginning in 1990 the inflation adjustment factor for the earned income credit is 1.1918042117. Accordingly, for taxable years beginning in 1990, the credit is equal to 14 percent of the first $6,810 of earned income. The credit will be phased out at a rate of 10 percent of the amount of adjusted gross income (or, if greater, the earned income) that exceeds $10,730. The maximum credit allowable will be $953.40 (.14 × $6,810). The credit will phase out completely at $20,264 of adjusted gross icnome, or earned income, as the case may be ($10,730 plus ($953.40/.10) = $20,264).

SEC. 7. ADJUSTED PERSONAL EXEMPTION

.01 Section 151(b) of the Code generally allows a taxpayer an exemption for himself or herself. Section 151(c) generally allows a taxpayer additional exemptions for dependents as defined in section 152. As provided in section 151(d)(1), the exemption amount for taxable years beginning after 1988 is $2,000. The $2,000 amount is subject to adjustment for inflation.

.02 As stated in section 3.03 above, for tax years beginning in 1990 the inflation adjustment factor for the personal exemption is 1.0474489067. Applying the factor to the $2,000 figure set forth in section 151(d)(1) of the Code results in a figure of $2,094.89. Accordingly, due to the $50 "rounding-down" provisions of section 1(f)(6), the personal exemption for tax years beginning in 1990 is $2,050.

SEC. 8. EFFECTIVE DATE

This revenue procedure is applicable for all taxable years beginning in 1990.

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26 CFR 601.602: Tax forms and instructions.

Rev. Proc. 90-8

CONTENTS

PART A. GENERAL
SECTION 1. PURPOSE
SECTION 2. SCOPE
SECTION 3. NATURE OF CHANGES
SECTION 4. DEFINITIONS
SECTION 5. MESSAGE TO RETURN PREPARERS
SECTION 6. HIGHLIGHTS OF PERMITTED CHANGES
SECTION 7. APPROVAL
SECTION 8. OMB REQUIREMENTS
SECTION 9. GENERAL GUIDELINES
SECTION 10. PAPER REQUIREMENTS
SECTION 11. PRINTING REQUIREMENTS
SECTION 12. MARGIN REQUIREMENTS
SECTION 13. APPROVED SCHEDULE FORMATS
SECTION 14. REQUIRED FORM PREPARATION
SECTION 15. LINE COMPLETION EXCEPTIONS
SECTION 16. SUPPORTING STATEMENTS
SECTION 17. FILING SPECIFICATIONS
SECTION 18. OTHER REVENUE PROCEDURES
SECTION 19. ORDERING REVENUE PROCEDURES
SECTION 20. ORDERING REPRODUCTION PROOFS
SECTION 21. AGREEMENT

PART B. SPECIFIC
SECTION 1. GENERAL
SECTION 2. CONDITIONS—TAX RETURNS
SECTION 3. PERMITTED GRAPHICS CHANGES
SECTION 4. FORM 1040A GRAPHICS
SECTION 5. PROHIBITED CHANGES
SECTION 6. FORM 1040 GRAPHICS
SECTION 7. PROHIBITED CHANGES
SECTION 8. ACCEPTABLE FORMATS
SECTION 9. FORMS NOT SHOWN AS EXHIBITS
SECTION 10. PREPARING COMPUTER-GENERATED SUBSTITUTES
SECTION 11. ADDITIONAL INSTRUCTIONS
SECTION 12. FILING SUBSTITUTE FORMS
SECTION 13. FORM 1040EZ OCR REQUIREMENTS
SECTION 14. FORM 941 OCR REQUIREMENTS

SECTION 15. FORM 1042S SUBSTITUTES
SECTION 16. SUBSTITUTE SCHEDULE K-1 SPECIFICATIONS
SECTION 17. PRINTING IRS ENVELOPES
SECTION 18. SUBSTITUTE FORMS 5471
SECTION 19. ELECTRONIC FILING
SECTION 20. FTD PAYMENTS
SECTION 21. EFFECT ON OTHER DOCUMENTS

PART C. EXHIBITS
EXHIBIT A-1. SCHEDULE A (Preferred)
EXHIBIT A-2. SCHEDULE A (Acceptable)
EXHIBIT B-1. SCHEDULE B (Preferred)
EXHIBIT B-2. SCHEDULE B (Acceptable)
EXHIBIT CG-A. SCHEDULE A (Computer generated)
EXHIBIT CG-B. SCHEDULE B (Computer generated)
EXHIBIT CG-1040(1). FORMS 1040—PAGES 1 (Computer-generated composite example)
EXHIBIT CG-1040(2). FORMS 1040-PAGES 2 (Computer-generated composite example)

PART A.—GENERAL

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide the general requirements and conditions for the development, printing, and approval of all substitute tax forms to be acceptable for filing in lieu of official IRS produced and distributed forms for Tax Year 1989. All IRS tax forms, whether or not specifically mentioned herein by title or form number, are covered by this general revenue procedure. Certain unique, specialized forms (e.g., Forms 1040-ES, 1041-ES, 5498, 1096, 1099 series, W-2 series, W-9, etc.) require the use of other, additional revenue procedures to supplement this publication. See Sections 18 and 19 for further information on these specific forms.

SEC. 2. SCOPE

.01 The Service accepts quality substitute tax forms that are consistent with the official forms they represent, and that do not have an adverse impact on our processing. The IRS Substitute Forms Program administers the formal acceptance and processing of these forms nationwide. While this program deals primarily with paper documents, it also interfaces with other processing and filing mediums such as magnetic tape, optical character recognition, electronic filing, etc., within a totally integrated tax administration system.

.02 Only those substitute forms that conform to the corresponding official forms and that comply fully with the requirements set forth herein are acceptable.

.03 This revenue procedure is updated annually to reflect pertinent tax year form changes and to meet processing and/or legislative requirements.

SEC. 3. NATURE OF CHANGES

.01 Various editorial changes have been made.

.02 The use of either a preparer-derived name control or IRS preprinted check digits, as part of substitute label information, has been rescinded.

.03 Criteria for acceptable computer-generated substitute tax returns have been clarified.

.04 Entire contents has been updated to reflect Tax Year 1989 requirments.

.05 Forms 1040 and 1040A name and address criteria have been significantly revised.

.06 Text has been revised and restructured for clarity and consistency.

.07 Substitute forms that deviate from the specifications in this revenue procedure are not acceptable.

SEC. 4. DEFINITIONS

.01 *Substitute Form.* A tax form (or related schedule) that differs in any way from the official version and is intended to replace the entire form that is printed and distributed by the Service. This term also covers those approved substitute forms exhibited in this revenue procedure.

.02 *Printed (or Pre-printed) Form.* A form produced using conventional printing processes. Also, a printed form which has been reproduced by photocopying or similar processes.

.03 *Preprinted Pin-Fed Form.* A printed form that has marginal perforations for use with automated and high-speed printing equipment.

.04 *Computer-Prepared Substitute Form.* A pre-printed form in which the taxpayer's tax entry information has been inserted by a computer, computer-printer or other computer-type equipment, such as word-processing equipment.

.05 *Computer-Generated Substitute Form.* A form that is entirely designed and printed by the use of a computer printer on either lined or color-barred paper, so that all the line numbers, line captions, and the tax amount data entries are in the same computer typeface. No graphics usually appear on the form.

.06 *Computer-Generated Tax Returns.* A tax return that is entirely designed and printed by the use of a computer printer on plain white paper, as an exact textual and graphic reproduction of the corresponding Service tax return. Examples of tax returns are Forms 1040, 1040A, 1040EZ, 1041, 1065, 1120, etc.

.07 *Manually Prepared Form.* A pre-printed reproduced form in which the taxpayer's tax entry information is entered by an individual using a pen, pencil, typewriter, or other non-automated equipment.

.08 *Graphics.* Those parts of a printed tax form that are not tax amount entries or called-for information. Generally, these are line numbers, captions, shadings, instructions, special indicators, borders, rules, and strokes created by typesetting, photographics, photo-composition, etc.

.09 *Acceptable Reproduced Form.* A photocopy of an original form or of an unchanged reproduction proof supplied by the Service. (A reproduction is not a substitute form, but may subsequently be used as a computer-prepared substitute).

.10 *Supporting Statement (Supplemental Schedule).* A document providing detailed information to support an entry for a line(s) on an official or approved substitute form and filed with (attached to) a tax return. (A supporting statement is not a tax form and does not take the place of an official form, unless specifically permitted elsewhere in this procedure).

.11 *Specific Form Terms.* The fol-

lowing terms are used throughout this revenue procedure in reference to all substitute forms.

1 *Format.* The overall physical arrangement and general layout of a substitute form, as represented by the official form version.

2 *Sequence.* The same numeric and logical placement order of data, as reflected on the official form version. Sequence is an integral part of the total format requirement.

3 *Line Reference (Code).* The line numbers, letters or alpha-numerics used to identify each captioned line on the official forms; and printed to the immediate left of each caption or data entry field.

4 *Item Caption.* The textual portion of each line on the form, identifying the specific data elements required.

5 *Data Entry Field.* All areas designated on a form for the insertion of data, such as dollar amounts, quantities, responses, check-boxes, etc.

SEC. 5. MESSAGE TO TAX RETURN PREPARERS

.01 If you plan to change or modify any tax forms, you must follow these procedures, and, in many cases, you must get official approval before using substitute forms. The Service is continuing a program to identify and contact tax return preparers using unapproved forms which do not conform to this revenue procedure and impede processing of the return.

SEC. 6. HIGHLIGHTS OF PERMITTED CHANGES AND REQUIREMENTS

.01 THINGS YOU *CAN DO* TO INTERNAL REVENUE SERVICE PRINTED TAX FORMS TO MAKE THEM SUITABLE FOR USE AS SUBSTITUTE TAX FORMS WITHOUT PRIOR APPROVAL.

1 You can photocopy most tax forms and use them instead of the official ones. Generally, forms that totally conform to the requirements specified in this revenue procedure may be privately printed without prior approval. Proposed substitutes not conforming to these requirements must be submitted for prior approval.

(a) See excluded forms in .01.7 below.

2 You can reproduce any current tax form as cut sheets, snap-sets, and marginally-punched, pin-fed forms, so long as you use an official Service version as the master copy. Official versions are supplied by the Service, such as those in the taxpayer's tax package, those in Package X, those printed in revenue procedures, reproduction proofs sold by the Service, and over-the-counter forms available at IRS and other governmental public offices or buildings.

3 You can adjust the graphics on specified areas of printed Forms 1040 and 1040A (and other forms) to allow for computer-printed or word processor fill-in. Only the areas listed in this revenue procedure may be adjusted without specific prior approval.

4 You can print and duplicate the substitute "worksheet-type" versions of Schedules A and B of Form 1040 (see exhibits). The Service will accept these substitute schedules instead of the official versions. These Schedules serve different purposes. One allows the form to contain state tax information which is blocked out before filing with the service. The other allows the form to be used singly or as part of a snap-set.

5 You can create a "signature form" as a valid substitute form. Many tax forms (including returns) have a taxpayer signature requirement as part of the form layout. The jurat/perjury statement/signature line areas must be retained and worded exactly as on the official form, but the requirement for a signature by itself does not prohibit a tax form from being properly computer generated.

6 You can computer-generate TAX RETURNS THEMSELVES (i.e., forms requiring a signature and that establish tax liability; including, but not limited to Forms 1040, 1040A, 1040EZ, 1120, 940, 941, 5500 series returns and schedules, 1041, 720, 1065, and all similar tax return forms) on plain white paper, but only as exact textual and graphic reproductions of the official Service forms. These returns may be filled in by a computer, by a word processor, or the like, but the forms themselves must be printed exactly like the Service (official) versions are.

(a) Schedules are considered to be an integral part of the tax return itself, and therefore cannot be computer-generated, when they have been assigned consecutive page numbers and printed contiguous with page one of the return. Form 706, United States Estate Tax Return, is an example of this situation, where Schedules A through R have pages numbered as part of the basic return and cannot be separately computer-generated.

(b) However, Schedule 1 of Form 1040A is an example of when a schedule can be acceptably computer-generated. Although IRS-printed as a continuation of Form 1040A, the two pages of Schedule 1 do not have consecutive page numbers, and may therefore be separated from 1040A and submitted as a computer-generated substitute schedule.

(c) A "tax return" must remain complete, with its signature covering the entire return including all its assigned or associated (numbered) pages.

7 Some Service forms should never be reproduced as photocopies, or submitted on carbon copies, for intended use as substitute forms. This is because only the original or official versions are acceptable for filing with the IRS, due to their use in critical Service programs that normally require use of only OCR scannable documents.

(a) Forms W-2, W-2G, W-2P, W-3, 1096, 1098, 1099-A, 1099-B, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, 1099-PATR, 2284, 1099-R, 1099-S, 5498, 8109, and 8109-B are the major forms that fall in this excluded category.

(b) Most of these forms have the provision for assessment of penalties for the submission of non-OCR scannable substitute versions. For further information, see Publication 1179 (revised annually).

.02 THINGS YOU *CANNOT DO* TO INTERNAL REVENUE SERVICE PRINTED TAX FORMS TO MAKE THEM SUITABLE FOR USE AS SUBSTITUTE TAX FORMS.

1 You cannot, without prior Service approval, change any Internal Revenue Service tax forms or use your own (non-approved) version, unless specifically permitted by this revenue procedure. Only minor changes are permitted to an official tax form, as OMB approval for IRS use was based on the specific format and

content of each form submitted by IRS. Once approved, IRS does not have the authority to change (or to authorize changes) to the official forms.

2 You cannot adjust any of the graphics on Forms 1040, 1040A and 1040EZ (except in those areas specified in this revenue procedure) without prior approval from the Service.

3 You cannot use your own version of Schedule A (Form 1040) unless you first get it approved. The Service wants only one Schedule A—either yours or ours; yours needs prior approval from the Service.

4 With some exceptions, you cannot omit filling out pertinent referenced (numbered or lettered) lines of the official Schedule A (and other tax forms) when attaching a supporting statement. Exceptions to line completion requirements are listed in this revenue procedure.

5 You cannot use your own preprinted label on tax returns filed with the Service, unless you fully comply with the exception criteria specified in Section 17.06.

.03 THINGS YOU CAN DO TO FILE COMPUTER-PREPARED/GENERATED FORMS. PRIOR APPROVAL IS NOT REQUIRED.

1 You can duplicate the approved, computer-generated formats of Schedules A and B (of this revenue procedure), and use them without further approval.

2 You can fill in official Internal Revenue Service supplied forms using computer or word-processing equipment. Internal Revenue Service forms are designed for a vertical spacing of six lines to the inch, with money amount columns wide enough to allow for the computer printing of ten characters.

3 You can change certain specified areas on the Forms 1040 and 1040A (spelled out in the revenue procedures) to assist computer-printing requirements and to allow for a little more room on certain lines.

4 If you meet the requirements, standards, and qualifications of this revenue procedure, *you can*, without prior approval, computer-generate your own substitutes of the tax forms (except for actual tax returns) not exhibited here. (See Agreement in Sec. 21).

SEC. 7. APPROVAL

.01 *Basic Requirements.* Preparers who desire to file substitute privately designed and printed tax forms and/or computer-generated and computer-prepared tax forms must develop such substitutes using these guidelines. These substitutes, unless excepted by revenue procedure, must be approved by the Service before being filed.

.02 *Requests for Approval*

1 The Service cannot approve your substitute form until the official form has been published. Please propose your substitute after you have examined the official form.

(a) The Service sometimes releases advance proof copies of selected major tax forms that are subject to further changes and OMB approval before their release in final format for printing and release to the public. You may submit proposed substitutes of these advance proof forms, but until the final forms evolve we can only grant interim approval, based solely on these early proofs. These advance proofs are subject to significant change before forms are finalized. If these advance proofs are used as the basis for your substitute forms, you will be responsible for subsequently updating your final forms to agree with the final official version before use.

2 You should know the Service revenue procedure relating to the official form before you attempt to alter the form to meet your needs. Any alteration of forms must be within the limits acceptable to the Service. It is possible that, from one filing period to another, a change in law or a change in internal need (processing, audit, compliance, etc.) may change the allowable limits for the alteration of the official form.

3 When specific approval of any substitute form is desired, a sample of the proposed substitute should be forwarded for consideration by letter to the Internal Revenue Service, Attention: Substitute Forms Program Coordinator, R:R:R, 1111 Constitution Avenue, N.W., Washington, DC 20224. To expedite multiple forms approval, we prefer that your proposed forms be submitted in separate sets by return. For example, Forms 1040 and their normally related schedules or attachments should be separated from Forms 1120, etc., if at all possible. Schedules and forms (i.e., Forms 3468, 4136, etc.) that can be used with more than one type of return (1040, 1041, 1120, etc.) should be submitted only once for approval, regardless of the number of different tax returns they may ultimately be associated with.

4 As no Service office except the one specified in Section 7.02.3 above is authorized to approve substitute forms, unnecessary delay may result if forms are sent elsewhere for approval. All such forms must be forwarded to the above address for formal control, review, and official approval. No IRS office is authorized to allow deviations from this reveneue procedure.

5 The Service does not review or approve the logic of specific software programs, nor confirm the calculations entered on forms output from those programs that are submitted for approval. The accuracy of the program itself remains the responsibility of the software package developer, distributor, or user. The Substitute Forms Program is primarily concerned with the pre-filing quality review of the final forms output, produced by whatever means, that are expected to be processed by IRS field offices.

.03 *When to Send Proposed Substitutes.* Proposed substitutes should be sent to the address listed in .02 above, as much in advance of the filing period for the form as possible. This is to allow adequate time for analysis and response and to permit notice to our field offices that your substitute is acceptable. Quarterly filed forms, such as the Form 941, must be submitted by the first day of the last month of the quarter.

.04 *Accompanying Statement.* When the sample substitute is submitted, there should be an accompanying statement that lists the form number of each substitute requested and details those items that deviate from the official form in position, arrangement, appearance, line numbers, additions, deletions, etc. Included with each of the items should be a detailed reason or justification for the change and an approximation of the number of forms expected to be filed.

.05 *Approval/Non-Approval Letter.* The Service sends a formal letter of approval/non-approval. Approval letters may contain qualifications for use of the substitutes. Non-approval letters may specify the changes required for approval, but also may require resubmission for approval. Telephone contact is used when warranted.

.06 *Duration of Approval.*

1 Approvals are good for only one calendar year (January through December) or, in the case of corporation tax forms (with the exception noted below), for the remainder of the quarters of the calendar year.

2 Please Note: In most cases each new filing season requires a new approval, even if the official form does not change. But see the exceptions in 3 and 4 below.

3 Exception: Quarterly tax forms in the 94X series (941, 942, etc.) are approved only for one quarter. Each new quarter requires a new approval.

4 Exception: Limited continued use of a change approved for one tax year may be allowed for the same form in the following tax year. See .07 below for the limitations and for other requirements. Examples of such changes are the use of abbreviated words, revised form spacing, compressed text lines, shortened captions, etc., which do not change the consistency of lines or text on the official forms.

.07 *Limited Continued Use of an Approved Change.*

1 If you received written approval of a previous tax year substitute form governed by this revenue procedure and wish to continue to use the approved change in your current tax year substitute form, you may revise your form to include this change and, without additional written approval, use it as a current tax year substitute form, provided you comply with the requirements in this revenue procedure. See exception in 2 below.

2 This means that if you received written approval for a specific change on a specific form last year, you may again make the same change on the same form this year, if the item changed is present on this year's official form. Thus, the change allowed in last year's approved substitute Schedule A, for example, can be continued in your new substitute for this year. The new substitute does not have to be sent to the IRS, and written approval is not required. However, the new substitute must conform to the official current year IRS form in other respects: date, Office of Management and Budget (OMB) approval number, sequence number, Paperwork Reduction Act Notice Statement, arrangement, item caption, line number, line reference, data sequence, etc. It must also comply with this revenue procedure—which may have eliminated, added to, or otherwise changed the guideline which affected the change approved last year. Additionally, you will be bound by the "Agreement" in Section 21.

3 Exception: Those written approvals which stated that the approved change or form would not be allowed in any other tax year, or for a temporary, limited, or interim approval pending resolution of a failure to meet one or more Service-prescribed requirements.

4 This authorization for continued used of an approved change is limited to the continuation of design logic from an immediately prior tax year substitute form to a current tax year substitute form.

.08 *Requested Copies.* In our letter of approval, *you may* be requested to send to the Service eleven (11) copies of each approved form. When received, the copies will be used to notify Internal Revenue Service Centers that your substitute forms are approved. The requested forms should be assembled in sets. A set constitutes a return with the related schedules and forms in the same order as they will be filed, i.e., Form 1040, Schedules A, B, C, etc., and associated Forms 2119, 2441, etc.

.09 *Responsibility.* Following the receipt of initial approval for a substitute forms package, or of a software output program to print substitute forms, it is the responsibility of the originator (designer or distributor) to provide each subsequent client firm or individual with the pertinent Service forms requirements which must be met for continuing acceptability. Examples of this responsibility include the use of prescribed print paper, font size, legibility, state tax data deletion, the legal requirement of the Paperwork Reduction Act Notice for informing all users of substitute forms of the official use and collection requirements stated in the instructions for the official IRS forms, completion of documents, etc.

.10 *Forms Approval Number.* The Substitute Forms Program Coordination Office, R:R:R, will assign a unique forms approval number to each firm that submits substitute forms for approval. This will be a permanently assigned control number that should be used on every form created by a particular firm.

1. This number should be printed at the bottom left margin area on the first page of every approved substitute form.

2. The Forms Approval Number consists of 4–6 positions, consisting of the following example configurations: H7348

(a) The first position (an alpha character), identifies the individual assigning the number within the Service.

(b) The second position (a numeric digit), identifies the year of issue of a number.

(c) The third position (a numeric digit), identifies the IRS Service Center with responsibility within the geographic location of the firm's *home* or *national* office location.

(d) The fourth, fifth, and sixth positions will be used as required, to identify the assigned numeric approval number (i.e., 1, 22, or 333, etc.).

3. This number should not be used on optically scanned (OCR) forms, except for certain specified Forms 1040-ES.

SEC. 8. OFFICE OF MANAGEMENT AND BUDGET (OMB) REQUIREMENTS FOR ALL SUBSTITUTE FORMS

.01 *Legal Requirements of the Paperwork Reduction Act of 1980.* Public Law 96-511 requires that: (1) OMB approve all Service tax forms, (2) each IRS form contains (in the upper right corner) the OMB approval number and any expiration date, and (3) each IRS form (or its instructions) state why IRS is collecting the information, how it will be used, and whether or not the information is required to be furnished. This information *must* be provided to every user of any official or substitute tax forms.

.02 *Application to Substitute Forms.*

1 *Approval Number and Date Is Required.* All substitute forms must contain in the upper right corner (see Marginal Printing, Sec. 12.02.1(c)) the OMB number and any expiration date that is on the official form.

2 Format Required (2 Options).

(a) OMB No. XXXX-XXXX (preferred) or OMB # XXXX-XXXX

(b) OMB No. XXXX-XXXX (preferred) Expires XXXXXX (mmddyy) or OMB # XXXX-XXXX Expires XXXXXX (mmddyy)

3 *Required Explanation to Users of Substitute Forms.* You must also inform the users of your substitute forms of the Service use and collection requirements stated in the instructions for the official Service form. If you provide your users or customers with the official IRS instructions, page 1 of each form must retain the Paperwork Reduction Act Notice Statement as on the official forms (usually in the lower left corner of the forms). Otherwise, you must duplicate the material in the statement and add the phrase, "For Paperwork Reduction Act Notice, See Separate Instructions".

(a) If the Service instructions are not provided to users of your forms, the exact text of the Paperwork Reduction Act Notice must be furnished separately. This notice reads,"We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information."

(b) If Service instructions are not provided, a copy of the alternative statement provided to users of your forms must be included with the forms you submit for approval.

.03 *Obtaining OMB Number, Date and Statement.* The OMB approval number, expiration date, and use and collection requirements may be obtained from the official printed form (or its instructions), the reproduction proof (or instructions), or from the Service.

SEC. 9. GENERAL GUIDELINES

.01 *Official Form is the Standard.* Because a substitute form is a variation from the official form, you should know the requirements of the official form for the year of use before you modify it to meet your needs. For the most frequently used tax forms, the quickest way to obtain an official form is to request reproduction proofs of these forms. (See Sec. 20.)

.02 *Design.* Each form must follow the design of the official form as to format, arrangement, item caption, line numbers, line references, and sequence.

.03 *State Tax Information Prohibited.* State tax information must not appear (be visible) on the federal tax return or associated form or schedule which is filed with the Internal Revenue Service, except where amounts are claimed on or required by the federal return, e.g,, line 5, Schedule A (Form 1040). (See Sec. 13.05 Block Out Methods.)

.04 *Federal and State Columns.* When a form is designed with both federal and state columns, the federal column must be to the left of the state column and adjacent to the line caption. Again, state tax information must not be on a federal tax form.

.05 *Vertical Alignment of Amount Fields.*

1 When a form is to be computer-prepared, you may remove the vertical line in the amount field that separates dollars from cents. When a form is to be computer-generated, vertically align the amount entry fields where possible. You must also use one of the ten-character amount formats shown in Part B, Sec. 3.04. Amount fields may be "rounded off" to dollars only, where form instructions specifically permit such entries.

2 When a form is to be manually prepared, the federal column must have a vertical line or some type of indicator in the amount field to separte dollars from cents if the official form has a vertical line. The cents column must be at least 1/8-inch wide.

.06 *Attachment Sequence Number.* Please note that most forms have an "attachment sequence number" located just below the year designation in the upper right corner of the form. The Service uses this number to indicate the order in which forms are processed when filed with a return. On computer-prepared forms it must be printed no less than 12-point, bold-face type and centered below the form's year designation. On computer-generated forms, place the sequence number following the year designation for the tax form and separate with an asterisk. It is not necessary to duplicate the "Attachment Sequence Number" wording, except for the actual number. (See Forms Exhibits at end of this Revenue Procedure).

.07 *Attachment Sequence Numbers Required.* The attachment sequence number is required on most IRS forms. Please note that some of the numbers necessarily change each year. The specific sequence numbers used on official IRS forms must be duplicated on the representative substitute form. If a sequence number is not provided on the official form, it is not required on a substitute of that form either.

.08 *Paid Preparer's Information and Signature Area.*

1 On Forms 1040A, 1040, and 1120, etc., the "Paid Preparer's Use Only" area may not be rearranged or relocated. You may, however, add three extra lines to the paid preparer's address area without prior approval. This applies to other tax forms as well.

2 On Form 1040EZ this information must be provided at the bottom of the form below the taxpayer's signature area. As an alternative, the printed Paid Preparer's Information and Signature Area from either a Form 1040 or 1040A may be attached to the bottom of Form 1040EZ.

.09 *Assemblage of Forms.* When filing a return, (i.e., Form 1040), the return must be arranged in this order: (1) the tax return, (2) Form 1040 schedules and forms in sequence number order, (3) all others (Form 1120, 1120S, 1065, 1041, etc.), lettered schedules (Schedule D, etc.) in alphabetical order and numbered forms in numerical order (Forms 2220, 4626, etc.), (4) supporting statements in the same sequence as the forms they support, and (5) additional information required or voluntarily submitted. In this way, they are received in the order in which they must be processed. If you do not send them to us in this order, the Service has to delay the return package to disassemble them and place them in this order before processing is continued.

SEC. 10. PHYSICAL ASPECTS AND REQUIREMENTS: PAPER

.01 *Paper Content.* The paper must be:

1 Chemical wood writing paper that is equal to or better than the quality used for the official form;

2 at least 18 pound (17″ × 22″, 500 sheets) or

3 at least 45 pound (25″ × 38″, 500 sheets).

.02 *Paper Prohibited.* Carbon-bonded paper is prohibited from use for all substitute forms filed with the Service.

.03 *Paper with Chemical Transfer Properties—Limited Use.* Chemical transfer paper for all substitute forms may be used only when the following specifications are met.

1 Each ply within the chemical transfer set of forms must be labeled.

2 Only the top ply (ply one and white in color), the one which contains chemical on the back only (coated back), may be filed with the Service. For example, a set containing three plies would be constructed as follows: ply one (coated back), "Federal Return, File with IRS"; ply two (coated front and back), "Taxpayer's copy"; and ply three (coated front), "Preparer's copy."

3 The file designation, "Federal Return, File with IRS," for ply one must be printed in the bottom right margin (just below the last line of the form) in 12-point, bold-face type. It is not mandatory, but recommended, that the file designation, "Federal Return, File with IRS," be printed in a contrasting ink for visual emphasis.

4 *Carbon Paper.* We prefer that you do not attach any carbon paper to any return you file with the Service.

.04 *Paper and Ink Color.* We prefer that the color of paper substantially duplicates that of the original form. You may use white paper. This means that your substitute must be printed in black ink and may be on white or on the color paper the Service form is printed on. Forms 1040A, 1040EZ, and 1040 substitute reproductions may be in black ink without the colored screening. The only exception to this rule is Form 1041-ES, which should always be printed with a very light gray shading in the color screened area. This is necessary to assist us in expeditiously separating this form from the very similar Form 1040-ES.

.05 *Page Size.* Substitute or reproduced forms and computer-prepared/generated substitutes may be the same size as the official form (8″ × 11″, in most cases) or they may be the standard commercial size (8 1/2″ × 11″) exclusive of pin-feed holes. The thickness of the stock cannot be less than .003 inch.

.06 *Lined Paper.* Computer-generated substitute forms must be submitted on quality lined, machine paper. Lined, color-barred paper (of any bar coloration) is also acceptable. Lined paper assists Service employees during processing of the returns by allowing speedy and accurate location of tax entries corresponding to line captions. The lines provide the basic means for eye-travel from one side of the form to the other, and significantly reduces processing errors. Only original forms should be filed with IRS, as copies frequently do not meet legibility requirements, especially copies of forms originally printed on color-barred paper stock.

.07 *Exceptions to Lined Paper Requirement.* If your printer has underlining capability, you do not have to use lined or color-barred paper so long as you consistently underline every other text line on the form. This may be every second, third, or fourth line of text. The underlining must be a continuous line and extend from the left text margin to the right text margin and be the same length for all lines on the page. Also, the use of printed vertical and horizontal graphics can produce an acceptable linear image of the official form, and is an approvable exception on a case by case basis.

SEC. 11. PHYSICAL ASPECTS AND REQUIREMENTS: PRINTING

.01 *Printing Medium.* The private printing of all substitute tax forms must be by conventional printing processes, photocopying, computer-graphics, or similar reproduction processes.

.02 *Legibility.* All forms must have a high standard of legibility, both as to printing and reproduction and as to fill-in matter. The Service reserves the right to reject those with poor legibility. The ink and printing method used must ensure that no part of a form (including text, graphics, data entries, etc.) develops "smears" or similar quality deterioration, including any subsequent copies or reproductions made from an approved master substitute form, either during preparation or during Service processing.

.03 *Type Font.* Almost all federal tax forms are printed using "News Gothic" as the basic type font. We request that you use this type font when composing any substitute forms.

.04 *Print Spacing.* Substitute forms should be printed using a 6 lines/inch vertical print option. They should also be printed horizontally in 10 pitch pica (i.e., 10 print characters per inch) or 12 pitch elite (i.e., 12 print positions per inch).

.05 *Image Size.* The image size of printed substitute forms should be as close as possible to that of the official form. You may omit any text on both computer-prepared and computer-generated forms that is solely instructional.

.06 *Title Area Changes.* To allow a larger top margin for marginal printing and more lines per page (see Sec. 12 below), the title line(s) for all substitute forms (not including the form's year designation and sequence number, when present), may be photographically reduced by 40 percent or reset as one line of type. When reset as one line, the type size may be no smaller than 14-point. You may omit "Department of the Treasury, Internal Revenue Service" and all reference to instructions in the form's title area.

.07 *Remove Government Printing Office Symbol.* When privately printing substitute tax forms, the Government Printing Office symbol and/or jacket number must be removed. In the same place, using the same type size, print the Employer Identification Number (EIN), the Social Security Number (SSN) of the printer or designer, or the IRS assigned Forms Approval Number. (We prefer this last number be printed in the lower left area of the first page of each form.)

.08 *Printing On One Side of Paper.* When it is preferred that both sides of the paper be used for substitute and reproduced forms, resulting in the same page arrangement as that

of the official form or schedule, the Service will not object if only one side of the paper is used.

.09 *Photocopy Equipment.* The Service does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms, but requires only that the reproduced forms satisfy the conditions stated in the revenue procedures.

.10 *Reproductions.* Reproductions of official forms and substitute forms which do not meet the requirements of this revenue procedure may not be filed instead of the official forms.

.11 *Removal of Instructions.* You may remove all references to instructions. No prior approval is needed. One exception is that the statement "For Paperwork Reduction Act Notice, See Instructions", must be retained or a similar statement provided on each form.

SEC. 12. PHYSICAL ASPECTS AND REQUIREMENTS: MARGINS

.01 *Margin Size.*

1 The format of a reproduced tax return when printed on the page must have margins on all sides at least as large as the margins on the official form. This allows room for Service employees to make the necessary entries on the form during processing.

2 A one-half to one-quarter inch margin must be maintained across the top, bottom, and both sides (exclusive of any pin-feed holes) of all computer-generated substitutes. The margin area is also used by Service employees to make necessary entries on the form during processing.

3 The marginal, perforated strips containing in the pin-feed holes must be removed from all forms prior to filing with the Service.

.02 *Marginal Printing.*

1 *Non-Tax Material Allowed in Limited Areas.*

(a) On any 8- or 8 1/2-inch-wide Service or substitute form, you may print your logo, company or firm name, identifying and collation symbols, etc., in *the left half of the top margin.*

(b) With the exception of the actual tax return forms (i.e., Forms 1040, 1040A, 1040EZ, 1120, 940, 941, etc.), you may also print in the *left vertical margin* and in the *left half of the bottom margin.*

(c) Printing is never allowed in the *right half of the top* of the tax return form (i.e. Forms 1040, 1040A, 1040EZ, 1120, 940, 941, etc). The Service uses this area to imprint a File Location Number for each return.

2 *Prior Approval Not Required.* Prior approval is not required for the marginal printing allowed in 1 above when used with the unchanged exhibits in this revenue procedure or when printed on an official form, on a photocopy of an official form, or on an (unchanged) IRS reproduction proof.

3 *Prior Approval Required.* The marginal printing allowance in 1 above is also the guide for the preparation of acceptable substitute forms. There is no exception to the requirement that no printing is allowed in the *right half of the top margin* of the tax return form.

SEC. 13. APPROVED SUBSTITUTE FORMATS FOR FORM 1040 SCHEDULES

.01 *Exhibits of Approved Formats.* Two sets of exhibits (Exhibits A-1, B-1, A-2 and B-2) are at the end of this revenue procedure. They are acceptable substitutes for the official forms. They are intended to be used in place of the official forms and may be used without prior approval. Both sets are usable for manual entry or computer preparation. Vertical spacing is six (6) lines to the inch. You may also refer to them as examples of how the guidelines in this revenue procedure may be used in some specific cases. Please note that the Service does not supply reproduction proofs for these exhibits.

.02 *Printing or Duplication of Exhibits A-1 and A-2 and B-1 and B-2.* You may (1) print these exhibits or (2) duplicate them photographically or by using photo-reproduction techniques, providing your printed or reproduced images are exactly like the ones in the exhibits. With the exception noted below, nothing can be changed.

.03 *EXCEPTION.* In Exhibit A-1 and A-2 you may change the areas containing "other" items (lines 1b, 7, 9b, 14, 20, 21 and 25) as follows: (1) the areas inside the perimeter of the boxes containing the dash leaders (---) may be used to print any particular deduction item associated with the corresponding deduction category, and (2) the dash-leaders may be removed (but you may not change the amount column box size or position).

.04 *Exhibits A-1 and A-2.*

1 *Exhibit A-1.* This substitute Schedule A format may be used as a single sheet or as one of the copies of a snap-set. It is designed to be used in place of the official Schedule A (Form 1040).

2 *Exhibit A-2.* This substitute Schedule A format may be used as a single sheet when both federal and state tax information is placed on the same form.

3 *No State Tax Information.* No state tax information can appear on these forms when filed with the Form 1040. The state column may be present but the *state tax information must not be visible* when filed with the Service. We prefer that the entire state column be *completely blocked out.*

.05 *BLOCK OUT METHODS.* A suggested method to block out state tax information is: (1) place the substitute form in a clear plastic folder, (2) on the folder, place a strip of opaque material the exact width and length of the column you wish to block out, then (3) photocopy the substitute form while still in the folder. The result will be a form with only the federal tax information visible. Another method is to take a black marking pen and, using either vertical or horizontal strokes, cross out the state figures. Carbon-interleaved sets may be used where the amounts entered in the state column are filled in with black carbon overprint. This copy may be filed with the return.

.06 *Exhibits B-1 and B-2.* These exhibits correspond to Exhibits A-1 and A-2, and the provisions in .04.1 and 2 above apply. Both of these exhibits are acceptable for use in place of the official Schedule B (Form 1040).

.07 *Exhibits A-1 and B-1 or A-2 and B-2.* These exhibits may be used as sets when the return calls for both Schedule A and B.

1 Acceptable computer-generated formats for these schedules are also shown in the Exhibits section of this revenue procedure. The exhibits are for Schedules A and B. They are acceptable substitutes for the official

versions of these forms. They are intended to be used (without change) in place of the official forms and may be used without prior approval. All lines (including those not used for tax information) must be printed. (Any change to text or format of an exhibit requires prior written approval.) Vertical spacing is six (6) lines to the inch. You may also refer to them as examples of how the guidelines in this revenue procedure may be used in specific cases.

2 A combination of upper and lower case print fonts is acceptable in producing the computer-generated forms included in this procedure.

3 This same logic for computer-generated forms can be applied to any Service form that is normally reproducible as a substitute form, with the exception of tax return forms as discussed elsewhere.

SEC. 14. REQUIRED PREPARATION OF FORMS

.01 *Completely Fill In Lines.* You must completely fill in all the specified numbered or referenced lines as they appear on the official forms on computer-prepared or generated forms, (not just the totals) but all the items that make up the totals as well, before attaching any supporting statement (see Sec. 15 below for exceptions).

.02 *IRS Processing of Forms.* The Service processes the return based on information entered on the official forms or approved substitutes. References are made to attachments only as required by law and as requirements direct. When you fail to complete all the pertinent lines on the official forms, Service Tax Examiners have to locate the information on your attachment and write it on the proper line of the official form. This time consuming process causes delays in processing the return and increases the potential for errors both in transcription and in interpretation.

.03 *Notification of Preparers.* The Service is continuing a program to notify preparers who fail to meet the requirements for acceptable substitute forms, as stated in this revenue procedure, through telephone and/or written contact by the affected IRS office.

SEC. 15. EXCEPTIONS TO LINE COMPLETION REQUIREMENTS

.01 *Zero Entries.* Detailed information for any deduction or income category may be omitted from the printout if the category total to be reported is zero. However, the substitute form must show the total (zero when applicable) for each category. This means when no tax information is applicable, leave the line blank.

.02 *Lines Captioned "Other" (All Forms).* It is not necessary to fill in every numbered or referenced line of tax forms when the line caption calls for "Other," i.e., "Other (itemize)," "Other (specify)," "Other (attach schedule)," etc. Examples of this exception are lines 1b, 7, 9b, 14, 20, 21 and 25 for Schedule A, Form 1040. When this occurs, you may use a supporting statement and enter only the total amount of these "Other" items on the line of the official form. However, we prefer that you use the space on the official form when it is adequate.

.03 *Schedule A (Form 1040).* All numbered and lettered lines must be filled in, if applicable. Supporting statements may be used to give the details of the totals entered on such lines but may not be used as a substitute for a collection of lines. For example, the detailed information for "Taxes" may not be shown on a supporting statement (supplemental schedule) and only line 8 filled in. Lines 5 through 7 must also be completed. Also, for example, the details of "State and local income taxes" may be shown on a supporting statement and the total of such taxes entered on line 5. Also, the total of itemized deductions must be entered on line 26.

1 On line 7 the term "excise tax" must not be entered in lieu of the legitimate automobile-related, state personal property tax. Enter valid personal property taxes identified only as "personal property tax" on Schedule A.

.04 *Schedule B (Form 1040).* Lines 2 and 4 need not be filled in on the form. A supporting statement may be used for the details of interest and dividend income and the appropriate totals of such income entered on lines 3 and 5, unless nominee distribution or acrrued interest criteria apply. (See the tax package instructions concerning interest and dividends).

.05 *Schedule C (Form 1040).* All lines must be filled in when applicable, except the line where "Other expenses-list type and amount" is listed. (See instruction in .02 above). Also, all Questions A through J must be present and answered, except that if box (4) on line E is checked, Question G may be skipped.

.06 *Schedule E (Form 1040)*

1 When there are entries on page 1 for any of Part I, the following requirements must be met: (1) In Part I, lines 1, 2, and 3, the questions must be answered and tax information must be entered on the lines provided.

2 Supporting statements may be used for the details of rental and royalty income and expenses. The appropriate totals must be carried over and entered in the total column for lines 4, 5, 12, 20, 21 and 25 through 29.

3 Part II (page 2)—The income and loss from various partnerships, estates or trusts, small business corporations, etc. also may be detailed on a supporting statement, but the appropriate total income and total loss must be entered on lines 31 through 43.

4 As applicable, either page 1 or page 2 may be filed separately and independently of each other, as a valid Schedule E. Both pages are not required, unless the entered tax data applies to all parts of the form, or unless line 43 requirements apply.

.07 *Schedule F (Form 1040).* If the cash method is used, only page one is needed. Otherwise both pages one and two must be entirely printed. Page two cannot be filed separately.

.08 *Schedule SE (Form 1040).* Either Short Schedule SE (page 1) or Long Schedule SE (page 2) may be used, as applicable. Most taxpayers can use the short Schedule SE. It is only necessary to file the applicable page.

SEC. 16. SUPPORTING STATEMENTS

.01 *Use of Supporting Statements.* Supporting statements are to be used to explain an individual line entry on an official or substitute form. Unless specifically authorized by this revenue

procedure (see Sec. 15), they must not be used to avoid completing required lines on the official form, or in lieu of a prescribed official schedule or form. Supporting statements are never to be used until the required official return or form they support are first totally filled in (completed). It is not acceptable to submit a blank or incomplete official form that refers to a supporting statement, and then to submit the form data entries solely on the statement, in lieu of completing a tax return or form.

.02 *Supporting Statements.* Supporting statements must: (1) provide details and explain entries made on the official form, (2) furnish all required information in the same sequence as called for on the official form, (3) furnish any additional information in the order of appearance on the form to which it refers, and (4) show taxpayer's name and social security number (SSN) or employer identification number (EIN), as applicable, and (5) clearly identify which official form it supports.

.03 *Cross-Reference.* Each supporting statement must be referenced to the form it supports, and the entry on the form must be cross-referenced to the supporting statement. For example, put "Statement X" on the top of the supporting statement that contains the identified line number and the supporting information, and put "See Statement X" on the line of the form that references the statement.

.04 *Extent of Use.* You may attach supporting statements to explain or support any line item on an official or approved substitute form.

.05 *Assemblage.* For filing purposes, supporting statements are not attached directly to their related forms. Rather, all supporting statements are assembled in the same sequence as the forms they support; they are then placed at the back of the form package, after the lettered and numbered forms (see Sec. 9.09).

.06 *Multiple Supporting Statements.* Supporting statements for each numbered or letter form must have a separate page for its supporting statement(s). Each page should be the size of the form it supports, or it may be 8" × 11" or 8 1/2" × 11".

.07 *Not Reviewed for Approval.* The Service does not give its approval for specific supporting statements. The taxpayer or the tax practitioner for the taxpayer, must meet the needs as they arise, using the guidelines in this revenue procedure.

SEC. 17. SPECIFICATIONS FOR FILING SUBSTITUTE FORMS

.01 *Filing Substitute Forms.* Follow the same instructions as for filing official forms. These instructions are in the taxpayer's tax package, or in the related form instructions.

.02 *Computer-Prepared Tax Forms.* For filing purposes, the Service will accept computer-prepared tax returns (i.e., Forms 1040, 1040A, 1040EZ, 1120, 940, 941, etc.) filled in by a computer or by word-processing equipment or similar manual equipment, but these forms must be preprinted.

.03 *Computer-Generated Forms.* For filing purposes, the Service will accept computer-generated versions of forms that are attached to individual and business income tax returns, provided the substitutes and their manner of completion meet the guidelines prescribed herein.

.04 *Combination of Manually Prepared and Computer-Prepared/Generated Forms.* For filing purposes, the Service will accept substitute tax forms that contain a combination of computer-prepared/generated and manually filled-in information.

.05 *Taxpayer and Preparer Signatures.* All taxpayer signatures on forms to be filed with the Service must be original signatures, affixed subsequent to the reproduction process. However, the income tax preparer can satisfy the manual signature requirement by signing a completed income tax return form, making a photocopy of the return form, and having the taxpayer sign and file the photocopy. (See Rev. Rul. 78-370, 1978-2 C.B. 336.)

.06 *Use Preaddressed Internal Revenue Service Label.* When filing a substitute return, always use the preaddressed label provided in the tax package the Service sent to the taxpayer, when available. This label should be requested from taxpayer-clients by the practitioner completing each tax return. The use of this label (or its precisely duplicated label information) is extremely important for the efficient, accurate, and economical processing of a taxpayer's return. Labeled returns indicate that a taxpayer is an established filer and permits us to automatically accelerate processing of those returns. This results in quicker refunds, accurate names/addresses and postal deliveries, and less manual review by IRS functions. If taxpayer name and/or address is incorrect, line out old material and insert the corrections on the preaddressed label provided, or on the surrounding return label area.

1 When the pre-printed Service label is not used; the same pre-printed label information consisting of the Social Security Number (SSN), and all name and address information from that label must be duplicated and printed or typed directly onto, either:

(a) Your own substitute label, or

(b) The prescribed name and address area of the tax return itself.

2 Do not under any circumstances include either the Service pre-printed check digits or a practitioner-derived Name Control on any return prepared and filed with the Service.

3 Use only the following label information format for single filers:

000-00-0000
JOHN Q. PUBLIC
310 OAK DRIVE
HOMETOWN, STATE 94000

4 Use only the following information format for joint filers:

000-00-0000 000-00-0000
JOHN Q. PUBLIC
MARY I. PUBLIC
310 OAK DRIVE
HOMETOWN, STATE 94000

.07 *Use Internal Revenue Service Envelope.* When filing substitute or reproduced forms, use the envelope enclosed with the taxpayer's tax package. This envelope is coded for sorting into several categories. Use of the coded envelope can help speed up the processing and reduce processing costs. Do not use the Service-provided, tax-package envelope for other correspondence with the Service, as its misuse can delay the correspondence. (See Section 17 for the only acceptable exception to the use of official IRS envelopes).

.08 *Voluntarily Submitted Information.* Additional information required or voluntarily submitted should be on the same size paper as the official form and attached to the

return following the supporting statements. (See Sec. 9.09.)

SEC. 18. GUIDANCE FROM OTHER REVENUE PROCEDURES

.01 Guidance for the substitute tax forms not covered in this revenue procedure and the revenue procedures which govern their use, are as follows:

1 Revenue Procedure 88-55, IRS Publication 1355, Substitute Form 1040-ES requirements.

2 Revenue Procedure 89-41, IRS Publication 1141, Specifications for Private Printing of Substitute Forms W-2, W-2P, and W-3.

3 Revenue Procedure 87-12, IRS Publication 1149, Magnetic Tape Reporting for Windfall Profit Tax Information Returns.

4 Revenue Procedure 89-42, IRS Publication 1179, Requirements for Reproducing Paper Substitutes of Forms 1096, 1098, 1099 Series, 5498, and W-2G.

5 Revenue Procedure 87-63, IRS Publication 1187, Filing Forms 1042S on Magnetic Tape.

6 Revenue Procedure 89-43, IRS Publication 1220, Requirements and Conditions for Filing Information Returns in the Forms 1098, 1099, 5498, and W-2G on Magnetic Tape, 5 1/4 inch Magnetic Diskette, and 3 1/2 inch Magnetic Diskette.

7 Revenue Procedure 83-63, IRS Publication 1223, Specifications for Private Printing of Substitute Forms W-2C and W-3C.

8 Revenue Procedure 89-44, IRS Publication 1255, Requirements and Conditions for Filing Information Returns in the Forms 1098, 1099, 5498, and W-2G on 8 inch Magnetic Diskette.

SEC. 19. ORDERING REVENUE PROCEDURES

.01 If you receive Publication 1045, Information for Tax Practitioners, you may use the Form 3975G, Order Blank for Revenue Procedures, contained therein to order the following revenue procedures:

1 Pub. 1141, the revenue procedure on specifications for private printing of Forms W-2, W-2P, and W-3.

2 Pub. 1355, the revenue procedure on the requirements for substitute Form 1040-ES.

3 Pub. 1167, the revenue procedure on substitute printed, computer-prepared, and computer-generated tax forms and schedules.

4 Pub. 1179, the revenue procedure on paper substitute information returns (Forms 1099, 1098, 5498, 1096, and W-2G.

5 Pub. 1192, Catalog of Reproducible Forms and Instructions.

6 Pub. 1220, the revenue procedure on magnetic tape and magnetic diskette reporting for information returns (Forms 1099, 1098, 5498, and W-2G).

7 Pub. 1223, the revenue procedure on substitute Forms W-2C and W-3C.

8 Pub. 1255, the revenue procedure on 8 inch magnetic diskette reportng for information returns (Forms 1099, 1098, 5498, and W-2G).

9 Pub. 1345, Specifications for Electronic Filing of Individual Income Tax Returns (Tax Year 1989).

.02 The above listed revenue procedures may be obtained also by writing to the appropriate Forms Distribution Center address below, according to your geographic state location. Be sure to order using IRS Publication number. If you are located in:

1 Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming, send your request to:

WADC
Attn: 3975 Order
Rancho Cordova, CA 95743-0001

2 Alabama, Arkansas, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Nebraska, North Dakota, Ohio, Oklahoma, South Dakota, Tennessee, Texas, Wisconsin, send your request to:

CADC
Attn: 3975 Order
P. O. Box 9903
Bloomington, IL 61799

3 Connecticut, Delaware, District of Columbia, Florida, Georgia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, Rhode Island, South Carolina, Vermont, Virginia, West Virginia, as well as all foreign countries and U.S. possessions, send your request to:

EADC
Attn: 3975 Order
P. O. Box 27322
Richmond, VA 23261

SEC. 20. ORDERING REPRODUCTION PROOFS

.01 The Service provides for the public camera-ready, reproduction proofs of many of its printed tax forms. These reproduction proofs can only be ordered by using Form 6747, Order for Reproduction Proofs. Form 6747 can be obtained by request from the EADC (see address above) or by ordering IRS Publication 1192, Catalog of Reproducible Forms and Instructions (which contains Form 6747).

1 Recorded forms distribution information is continuously available, and may be accessed by dialing (804) 329-6670 or 1056 (not toll-free numbers). This recording provides for the receipt of form requests and inquiries at the end of the taped message.

.02 Basic specifications, such as margin, pagination, etc., will be printed in the margins of the reproduction proofs and must be removed before printing. The official reproduction proof margins across the top, bottom, and sides must be maintained on all reproductions and substitute forms.

.03 A charge of $1.00 per page will be made for each reproduction proof regardless of page size. Remittance is to be submitted with your order for reproduction proofs.

SEC. 21. AGREEMENT

Any person or company who uses substitute forms and makes all or part of the changes specified in this revenue procedure, agrees to the following stipulation: The Service presumes the changes are made in accordance with these procedures and, as such, will be noninterruptive to the processing of the tax return. Should any of the changes prove to be not exactly as described, and as a result become disruptive to the Service during processing of the tax return, the person or company agrees to accept the determination of the Service as to whether or not the form may continue to be used during the filing season, and also agrees to work with the Service in correcting noted deficien-

cies. Notification of deficiencies may be made by letter, phone contact, or both.

PART B.—SPECIFIC

SECTION 1. GENERAL

The specifications contained in this part of the revenue procedure define specific, detailed requirements for certain forms and conditions. These specifications must be adhered to in producing acceptable substitute forms as defined herein.

SEC. 2. CONDITIONS—TAX RETURNS (FORMS 1040, 1040A, 1040EZ, 1120, etc.)

.01 Acceptable Forms.

1 COMPUTER-GENERATED VERSIONS. Computer-generated versions of a tax return form (e.g., Form 1040, 1040A, 1040EZ, 1120, etc. which requires a signature and that establishes tax liability) are now permitted but only under the following conditions.

(a) These substitute returns must be printed on plain white paper. Lined or color-barred paper is to be used for all other (non-tax return) forms.

(b) Substitute returns (e.g., Form 1040, 1040A, 1040EZ, 1120, etc.) must be exact textual and graphic reproductions of the Service tax returns that they represent. No text can be added, deleted, or changed. The end product result should be basically a mirror image of the Service tax return, to be acceptable. It must be readily identifiable as a valid tax return.

(c) Various computer-graphic print mediums such as laser printing, dot matrix addressable printing, etc. may be utilized to produce the substitute forms.

(d) The substitute return must be the same exact number of pages, and contain the same page text as the official return.

(e) All computer-generated tax returns MUST be submitted for approval prior to their use.

(f) See Exhibit CG-1040 in this revenue procedure for examples of acceptable type substitute computer-generated tax returns.

.02 Prohibited Forms.

1 Tax returns (e.g., Forms 1040, etc.) CANNOT be computer-generated on lined or color-barred paper, using the basic non-graphic layouts acceptable for all other (non-tax return) substitute forms and schedules.

2 Tax returns that differ in any manner from the official IRS forms, which makes them non-standard or unacceptable.

3 Any substitute tax return not approved prior to filing with the Service.

.03 CHANGES PERMITTED TO THE FORMS 1040, 1040A & 1040EZ.

1 Certain changes (listed below) are permitted to the graphics of the form without prior approval, but these changes apply only to preprinted forms as described in .01 above.

2 Changes not requiring prior approval are good only for the annual filing period, which is the current Tax Year.

3 Other Changes Not Listed. All changes not listed here require prior approval from the Service BEFORE the form may be filed with the Service.

SEC. 3. CHANGES PERMITTED TO GRAPHICS (FORMS 1040A, 1040 AND 1040EZ).

.01 *Adjustments.*

You may make minor vertical and horizontal spacing adjustments to allow for computer or word-processing printing. This includes widening the amount columns or tax entry areas so long as the adjustments do not exceed other provisions stated in revenue procedures. No prior approval is needed for these changes. However, the user of forms with such changes are bound by the "Agreement" in Part A, Section 21.

.02 *Name and Address Area.*

1 The horizontal rules and instructions within the name and address area may be removed and the entire area left blank; no line or instruction can remain in the area. However, the statement regarding use of the IRS mail label should be retained.

2 The heavy ruled border (when present) that outlines the name and address area must not be removed, relocated, expanded or contracted.

3 Required Format

(a) When the name and address area is left blank, as provided in 1 above, the following format must be used when printing the taxpayer's name and address. Otherwise, unless the taxpayer's preprinted label is affixed over the information entered in this area, the lines must be filled-in as shown.

1st name line (35 characters maximum)

2nd name line (35 characters maximum)

In-care-of name line (35 characters maximum)

City, State (24 char. max.), one blank char., & ZIP (five char.)

(b) When there is no in-care-of name line, the name and address will consist of only three lines (single filer) or four lines (joint filer). Examples of the formats follow:

Example of name and address (joint filer) with no in-care-of name line:

JOHN Z. JONES
MARY I. JONES
1234 ANYWHERE ST., APT 111
ANYTOWN, STATE 12321

Example of name and address (single filer) with in-care-of name line:

JOHN Z. JONES
C/O THOMAS A. JONES
4311 SOMEWHERE AVE.
SAMETOWN, STATE 54345

.03 *Social Security Number (SSN) And Employer Identification Number (EIN) Area.*

1 The vertical lines separating the format arrangement of the SSN/EIN may be removed.

2 When the vertical lines are removed, the SSN and EIN formats must be 000-00-0000 or 00-0000000, respectively.

.04 *Cents Column.*

1 You may remove the vertical rule that separates the dollars from the cents.

2 All entries in the amount column should have a decimal point following the whole dollar amounts whether or not the vertical line that separates the dollars from the cents is present.

3 You may omit printing the cents, but all amounts entered on the form must follow a consistent format. You are strongly urged to round off the figures to whole dollar amounts, following the official return instructions.

4 When printing money amounts, you must use one of the following ten-character formats: (a) 0,000,000. (b) 000,000.00

5 When there is no entry for a line, leave the line blank.

.05 *"Paid Preparer's Use Only" Area.*

1 On all forms, where present, the paid preparer's information area may not be rearranged or relocated.

2 You may add three lines and remove the horizontal rules in the preparer's address area.

3 Form 1040EZ preparers must sign the return and provide all other required information. This information should be provided at the bottom of the form below the taxpayer's signature area. (See Part A, Section 9.)

SEC. 4. CHANGES PERMITTED TO FORM 1040A GRAPHICS

No prior approval is needed for the following changes (for use with computer-prepared forms only):

.01 *Line 4.*

The line caption may be compressed vertically to one line (to allow for same line entry for the name of the qualifying child) by using the following caption: "Head of household; child's name" (name field)

.02 *Other Lines.*

Any line whose caption takes up two or more vertical lines may be compressed to one line by using contractions, etc., and by removing instructional references.

.03 *Page 2 (Form 1040A).*

All lines must be present and numbered in the order shown on the official form. These lines may also be compressed as in .02 above.

.04 *Color Screening.*

It is not necessary to duplicate the color-screening used on the official form. A substitute Form 1040A may be printed in black and white only, with no color screening.

SEC. 5. OTHER CHANGES PROHIBITED

No other changes to the Form 1040A graphics are allowed without prior approval.

SEC. 6. CHANGES PERMITTED TO THE FORM 1040 GRAPHICS

No prior approval is needed for the following changes (for use with computer-prepared forms only)

.01 *Line 4.*

This line may be compressed horizontally (to allow for a larger entry area for the name of the qualifying child) by using the following caption: "Head of household; child's name" (name field)

.02 *Line 6c.*

The vertical lines separating columns (1) through (5) may be removed. The captions may be shortened to allow a one-line caption for each column.

.03 *Other Lines.*

Any other line whose caption takes up two or more vertical lines may be compressed to one line by using contractions, etc., and by removing instructional references.

.04 *Line 22.*

1 This line may be expanded vertically to a maximum of 3 lines.

2 The amount entry box must remain a single entry.

.05 *Line 38.*

You may change the line caption to read "Tax" and computer-print either the words "FROM TAX TABLE," "TAX RATE SCHEDULE," or "FORM 8615" as the appropriate text.

.06 *Line 39.*

You may change the caption to read: "Additional taxes from Form" and computer-print only the form(s) that apply.

.07 *Line 44.*

You may change the caption to read: "General business credit from Form" and computer-print only the form(s) that apply.

.08 *Line 50.*

You may change the caption to read: "Recapture taxes from Form" and computer-print only the form(s) that apply.

.09 *Color Screening.*

It is not necessary to duplicate the color-screening used on the official form. A substitute Form 1040 may be printed in black and white only, with no color screening.

SEC. 7. OTHER CHANGES PROHIBITED

No other changes to the Form 1040 graphics are permitted without prior approval.

SEC. 8. ACCEPTABLE FORMATS OF COMPUTER-GENERATED FORMS AND SCHEDULES

.01 Exhibits of acceptable computer-generated formats for the schedules usually attached to the Form 1040 are shown in the Exhibits section of this revenue procedure.

.02 Use of Acceptable Formats. If your computer-generated forms appear exactly like the exhibits, no prior authorization is needed.

.03 Changes to exhibits are not permitted without prior approval. Any change to the text or format of any of the exhibits requires prior written approval.

SEC. 9. COMPUTER-GENERATED FORMS NOT SHOWN AS EXHIBITS IN THIS REVENUE PROCEDURE

.01 Those desiring to computer-generate forms not shown here may do so, but they must design such forms themselves by following the manner and style of those in the Exhibits section of this publication, and by taking care to observe other requirements and conditions stated here.

.02 Computer-generated forms so designed do not require prior approval from the Service. However, the user of such forms is bound by the "Agreement" in Part A, Sec. 21 above. The Service encourages the submission of all proposed forms for review and approval.

.03 If you wish, you may submit any substitute form to the Service for approval consideration, or you may submit only a representative sample of your forms.

SEC. 10. INSTRUCTIONS FOR PREPARING COMPUTER-GENERATED SUBSTITUTES

.01 *Format Arrangement.*

The format of each substitute schedule or form must follow the format of the official schedule or form as to item captions, line references, line numbers, sequence, form arrangement and format, etc. Basically try to make the form look like the official one, with readability and consistency being primary factors. Use periods and/or other special characters to separate the various parts and sections of the form. With the exceptions in .02 below, all line numbers and items must be printed even though an amount is not entered on the line.

.02 *Line Numbers.*

1 When a line on an official form is designated by a number or a letter, that designation (reference code) must be used on a substitute form.

2 The reference code must be printed to the left of the corresponding captioned line and also immediately preceding the data entry field even if there is no reference code immediately preceding the data entry field on the official form.

3 In addition, the reference code that is immediately before the data field must either be followed by a period or enclosed in parentheses. There also must be at least two blank spaces between the period or the right parenthesis and the first digit of the data field. (See example below.)

4 A decimal point (i.e., a period) should be used for each money amount regardless of whether the amount is reported in dollars and cents or in whole dollars, or whether or not the vertical line that separates the dollars from the cents is present. The decimal points must be vertically aligned when possible.

Example:

5 STATE & LOCAL INC. TAX 5. 495.00
6 REAL ESTATE TAXES..... 6.
7 OTHER TAXES (LIST)..... 7. 198.00

or

5 STATE & LOCAL INC. TAX .....(5) 495.00
6 REAL ESTATE TAXES.....(6)
7 OTHER TAXES (LIST).....(7) 198.00

.03 *Multiple Page Forms.*

With the exceptions noted below, when printing multiple page forms the entire form with all its parts and pages must be printed. When printed on continuous forms, they must be burst and pin-feed holes removed before filing with the return.

.04 *Exception to Forms that must be entirely printed in whole or in part.*

1 On Schedule E, it is not necessary to print both pages if data does not apply. Either page one or page two can be printed and filed separately.

2 On Schedule F, depending on which accounting method is used (cash or accrual), the following will apply. If the cash accounting method is used only page one of Schedule F needs to be printed. Otherwise both page one and two must be entirely printed. Page two cannot be filed separately.

3 On Schedule SE, it is not necessary to print both pages. You may print either the Short Schedule SE (page 1), or the Long Schedule SE (page 2) as applicable.

SEC. 11. ADDITIONAL INSTRUCTIONS FOR ALL FORMS

.01 Internal control numbers and identifying symbols of the computer preparer may be shown on the substitute, if the use of such numbers or symbols is acceptable to the taxpayer and the taxpayer's representative. If shown, such information must not be printed in the top one-half inch clear area, from the center to the right edge, of any form or schedule requiring a signature. With the exception of the actual tax return form (i.e. Forms 1040, 1120, 940, 941, etc.), you may also print in the left vertical and bottom left margins. The bottom left margin you may use extends 3 1/2 inches from the left edge of the form. (See Part A, Sec. 12 for more information on this subject.)

.02 Descriptions for captions, lines, etc., appearing on the substitute forms may be limited to one print line by using abbreviations and contractions and by omitting articles, prepositions, etc. However, sufficient key words must be retained to permit ready identification of the caption, line or item.

1 Explanatory detail and/or intermediate calculations for derivation of fine line totals, may be included on the substitute. We prefer that such calculations be submitted in the form of a supporting statement. If intermediate calculations are included on the substitute, the line on which they appear may not be numbered or lettered. Intermediate calculations may not be printed in the right column. This column is reserved for official numbered and lettered lines that correspond to the ones on the official form. If a supporting statement is submitted, intermediate calculations or subtotals may be formatted at the preparer's option.

2 Text prescribed for the official form, which is solely instructional in nature, e.g., "Attach this schedule to Form 1040," "See instructions," etc., may be omitted from the substitute form.

3 Information for more than one schedule or form may not be shown on the same printout page. Except for high volume computer-generated Schedules A and B (Form 1040), almost any form may be continued on two or more pages if necessary. When a form is continued on two or more pages, clearly identify at the bottom of each page, including page 1, that is continued, e.g., "Page 1, Schedule C Continued." It is strongly recommended that a substitute form not exceed the same number of pages used for the official form.

(a) Both sides of the paper may be printed for multiple page official forms; but it is unacceptable to intermix single page schedules or forms, except for Schedules A and B which are printed back to back by the Service. For example, Schedule E can be printed on both sides of the paper, because the official form is multiple page, with page two continued on the back. However, for example, do not print Schedule E on the front page and Schedule SE on the back, or Schedule A on the front and Form 3903 on the back, etc. Both pages of a substitute form must match the official form version it represents, except that the back page may be blank if the Service form only contains the instructions thereon.

4 Identify all computer-prepared substitutes clearly; print the form designation one-half inch from the top margin and one and one-half inches from the left margin; print the title centered on the first line of print; and print the taxable year and, where applicable, the sequence number on the same line one-half to one inch from right margin. Include the taxpayer's name and SSN on all forms and attachments. Also print the OMB number and (when applicable) the forms expiration date, as reflected on the official form.

5 The state tax column may be present, but the state tax information must NOT be visible on the copy filed with the Service. When a form is designed with both federal and state columns, the federal column must be

to the left of the state column and adjacent to the line caption.

6 Attach all payments (check or money order—no cash) to the front of the tax return.

7 Negative (or loss) monetary amount entries should be enclosed in brackets, or signed minus, to assist in the accurate computation and input of form data. On many official forms the Service pre-prints brackets in selected negative data fields, and these designations should be retained or inserted on affected substitute forms.

SEC. 12. FILING SUBSTITUTE FORMS WITH THE SERVICE

Follow the same instructions as for filing official forms. These instructions are in the taxpayer's tax package.

SEC. 13. SPECIAL FORM 1040EZ OPTICAL CHARACTER RECOGNITION (OCR) REQUIREMENTS

.01 The Form 1040EZ is designed in OCR format. IRS has the capability to machine read this form by optical character recognition (OCR) equipment (Scan-Optics-System 540 and Recognition Equipment Inc.—Input 80 Model B Scanner).

.02 It is optional to produce the 1040EZ substitute as a normal (black and white) reproduction, or as an actual OCR version. The following criteria applies if the form is to be OCR scannable. Otherwise, you may print this form under the previous general guidelines of this Revenue Procedure.

.03 An acceptable substitute OCR Form 1040EZ must generally be an exact replica of the offical OCR reproduction proof with respect to layout, content and required OCR characteristics.

.04 The specific paper requirements which must be met for the development of a substitute (privately printed) OCR Form 1040EZ include the following:

1 Color and quality of paper—Paper must be white, OCR grade bond, with no fluorescent additives or water marks, and with zero rag content.

2 Reflectivity of paper—Must be 80% or greater.

3 Opacity—The paper opacity ratio must be 80% or more.

4 Paper Weight—Specified paper weight is 20 lb. OCR bond (.0035″).

5 Dirt—Must not exceed 10 parts per million.

6 Finish (smoothness)—Must be between 90 and 160 units (Sheffield).

7 Porosity—Paper should have a Gurley reading between 15 and 95.

8 Gloss—Paper with shiny or lustrous appearance (glossy) should be avoided.

9 Size—Form trim size must be 8″ × 11″.

.05 The specific ink requirements which must be met for this form include the following:

1 Print Color—The face of the form prints in black and green, the back prints in black only (70% screen).

2 Ink—Green ink used must be highly reflective OCR type, such as Sinclair and Valentine J-27975, or an exact match. Black ink used must be non-reflective.

3 Face Registration—Black to green must be .02″ (plus or minus) both horizontally and vertically.

4 Face Screen—Forms contain a green screened background equal to a 15% tone of 110-line screen. Follow registration marks on repro-proof for screen positioning. Handprint boxes are included on Page 1 of the reproduction proof and should be printed as a 50% value of the recommended OCR green ink. Inks used for handprint boxes must reflect at least 90% of the background on which it is printed as measured in the visible range.

5 Face Margins—Approximately 2/6″ head from top trimmed edge to screen (1/2″ to black image). 1/6″ outside from trimmed edges to screen. Exact margins are provided with reproduction proofs.

6 Back Margins—1/2″ head, 5/16″ foot, and 5/16″ sides.

7 Back Screen—Back copy should be screened for 70% tone value.

.06 *Typography*

Type must be substantially identical in both size and shape with corresponding type on the official form reproduction proof.

.07 To assure proper alignment and position of hand-printed characters representing return lines 1 through 9 tax data, they must be hand printed (entered) into the preprinted amount field boxes on the form. A #2 lead wooden pencil or blue or black ink pen (ball-point, fountain, or felt-tipped) are recommended as the writing tools which will consistently provide the required stroke width and print contrast on entered characters.

.08 Reading of handprinted characters requires adherance to the following techniques.

1 Enter numeric amount digits carefully and clearly. Fill at least 2/3 of the individual character box height, keeping the character within the box with no overlapping or touching characters. Specific required digit constraints are shown below.

2 When entering "fours", keep the top open.

3 When entering "ones", do not use serifs.

4 When entering "twos", do not add extra loops.

5 All character lines must be connected, with no gaps.

.09 *Color Screening.* On a non-OCR Form 1040EZ *only*, it is not necessary to duplicate the color-screening used on the official form. A substitute (non-OCR) Form 1040EZ may be printed in black and white, with no color screening required.

.10 All the general and detailed provisions of this Revenue Procedure apply (in addition to this specific OCR Section) for the development of substitute OCR Forms 1040EZ.

SEC. 14. SPECIAL FORM 941-OPTICAL CHARACTER RECOGNITION (OCR) REQUIREMENTS

.01 The Form 941 is designed in OCR format. The Service has the capability to machine read this form by Optical Character Recognition (OCR) equipment (Recognition Equipment Inc.—Input 80 Model B Scanner), if submitted in acceptable OCR format.

.02 Effective with forms filed for the first quarter of 1988, the Form 941 should be produced only in OCR scannable format. The following specific criteria apply if the substitute form is to be produced for OCR processing.

.03 An acceptable substitute OCR Form 941 must be an exact replica of the official reproduction proof with respect to layout, content, and required OCR characteristics.

.04 The specific paper requirements which must be met for the development of substitute (privately printed) forms generally duplicate those specified in Part B, Section 13, with the following exception:

1 Size-Form 941 trim size must be 8 1/2" × 11".

.05 The specific ink requirements which must be met for these forms include the following:

1 Print Color—Black and Red

2 Ink—Red ink must be a highly reflective (not less than 80%) OCR type ink, such as Sinclair/Valentine J6983 or an exact match. Black ink reflectance must not be greater than 15%.

3 Handprint Boxes (including the numbers outside the boxes)—These handprint boxes (for IRS entries and use only) are included on the reproduction proof, and should be printed as a 50% screen value of the recommended OCR red ink. Inks used for handprint boxes must measure 15% or less when tested using the MacBeth or Kidder testers (see #5 below).

4 Face Margins—Minimum margins require 1/2" head; center sides; and, 5/16" foot.

5 Testers—The following two print testers may be used for Form 941. Any other type tester must first be approved by the IRS.

(a) MacBeth PCM-II

Use "C" scale. Range must be between .01 minimum to .05 maximum.

(b) Kidder 082 A

Use infrared scale. PSC values must fall in the range of .32 minimum to .38 maximum. White calibration disk must be set at 100%. Sensitivity must be set at "1".

SEC. 15. PAPER SUBSTITUTES FOR FORM 1042S

.01 Paper substitutes for Form 1042S that *totally conform* to the specifications contained in this procedure may be privately printed without prior approval from the Internal Revenue Service. Proposed substitutes *not conforming* to these specifications must be submitted for consideration.

1 The request should be submitted by November 15 of the year prior to the year the form is to be used. This is to allow the Service adequate time to respond and the submitter adequate time to make any corrections. These requests should contain a copy of the proposed form, the need for the specific deviation(s), and the number of information returns to be printed.

2 Form 1042S is subject to annual review and possible change. Withholding agents and form suppliers are cautioned against overstocking supplies of the privately printed substitutes.

3 Copies of the official form for the reporting year may be obtained from most Service offices. The Services provides only cut sheets (no carbon interleaves) of these forms. Continuous fan-fold/pin-fed forms are not provided.

.02 *Instructions for Withholding Agents*

1 Only original copies may be filed with the Service. Carbon copies and reproductions are not acceptable.

2 The term "Recipient's U.S. tax identifying no.," for an individual means the social security number (SSN), consisting of nine digits separated by hyphens as follows: 000-00-0000. For all other recipients, the term means employer identification number (EIN). The EIN consists of nine digits separated by one hyphen as follows: 00-0000000. The tax identifying number must be in one of these formats.

3 Withholding agents are requested to type or machine print whenever possible, provide quality data entries on the forms (that is, use black ribbon, insert data in the middle of blocks well separated from other printing and guidelines), and take other measures to guarantee a clear, sharp image. Withholding agents are not required, however, to acquire special equipment solely for the purposes of preparing these forms.

4 On corrected returns, the words CORRECTED RETURN must be typed in all capital letters in the top 1/4 inch, right of center margin. All required information must be completed on a corrected return since it replaces and supersedes the information return previously filed.

5 Substitute forms prepared in continuous or strip form must be burst and stripped to conform to the size specified for a single form before they are filed with the Service. The dimensions are found below.

(a) Computer cards are acceptable, provided they meet all requirements regarding layout, content, and size.

.03 *Substitute Forms Format Requirements.*

1 Privately printed substitute Forms 1042S must be *exact replicas* of the official forms with respect to layout and contents. Only the dimensions of the substitute form may differ and the printing of the Government Printing Office symbol must be deleted. The exact dimensions are found below.

2 Line 1 must be present, line 2 may be omitted if it is not needed. If line 2 is omitted, also omit line 3.

3 None of the boxes can be omitted. Each box (a through h) must be present and in the exact order. The box for each payment amount must contain the appropriate caption.

4 Color and Quality of paper.

(a) Paper for Copy A must be white chemical wood bond, or equivalent, 20 pound (basis 17 × 22—500), plus or minus 5 percent; or offset book paper, 50 pound (basis 25 × 38—500). No optical brighteners may be added to the pulp or paper during manufacture. The paper must consist of principally bleached chemical woodpulp and be free from unbleached or ground woodpulp or recycled printed paper. It also must be suitably sized to accept ink without feathering.

(b) Copies B, C, and D (for Recipient) and E (for Withholding Agent) are provided in the official assembly solely for the convenience of the withholding agent. Withholding agents may choose the format, design, color and quality of the paper used for these copies.

5 Color and Quality of Ink—All printing must be in a high quality non-gloss black ink. Bar codes should be free from picks and voids.

6 Typography—Type must be substantially identical in size and shape to corresponding type on the official form. All rules on the document are either 1 point (0.015 inch) or 3 point (0.045). Vertical rules must be parallel to the left edge of the document; horizontal rules, parallel to the top edge.

7 Dimensions—The official form is 8 inches wide × 5 1/2 inches deep, exclusive of a 1/2 snap stub on the left side of the form. The snap feature is not required on substitutes.

(a) The width of a substitute Copy A must be a minimum of 7 inches and a maximum of 8 inches,

although adherence to the size of the official form is preferred. If the width of the substitute Copy A is reduced from that of the official form, the width of each field on the substitute form must be reduced proportionately. The left margin must be 1/2 inch and free of all printing other than that shown on the official form.

(b) The depth of a substitute Copy A must be a minimum of 5 1/6 inches and a maximum of 5 1/2 inches.

8 Carbonized forms or "spot carbons" are not permissible. Interleaved carbons, if used, must be of good quality to preclude smudging and should be black.

9 Other Copies—Copies B, C, and D are required to be furnished for the convenience of payees who are required to send a copy of the form with other federal and state returns they file. Copy E may be desired as a withholding agent's record/copy.

.04 *Additional Instructions*

1 Arrangement of Assembly—If all five parts are present, the parts of the assembly shall be arranged from top to bottom as follows: Copy A (Original), "For Internal Revenue Service," Copies B, C, and D, "For Recipient," and Copy E, "For Withholding Agent."

SEC. 16. SPECIFICATIONS FOR FILING SUBSTITUTE SCHEDULES K-1

Prior approval is NOT required for a substitute Schedule K-1 that accompanies Form 1065 (for partnership), a Form 1120-S (for small business corporation), or a Form 1041 (for fiduciary) when the substitute Schedule K-1 meets all of the following requirements.

.01 The Schedule K-1 must contain the payer and recipient's name, address and SSN/EIN.

.02 The Schedule K-1 must contain all line items required for use by the taxpayer.

.03 The line items must be in the same order and arrangement as those on the official form.

.04 The line items must be numbered, titled, and/or captioned exactly as shown on the official form.

.05 Each taxpayer's information must be on a separate sheet of paper. Therefore, all continuously printed substitutes must be separated, by taxpayer, before filing with the Service.

.06 Schedules K-1 for recipients must have instructions for required line items attached.

.07 You may be subject to penalties if you file Schedules K-1 with the Service and furnish Schedules K-1 to partners, shareholders, or beneficiaries that do not conform to the specifications of this revenue procedure.

.08 The amount of each partner's, shareholder's, or beneficiary's share of each line item must be shown. The furnishing of a total amount for each line item and a percentage (or decimal equivalent) to be applied to such total amount by the partner, shareholder, or beneficiary does not satisfy the law and the specifications of this revenue procedure.

.09 If you file Schedules K-1 not conforming to the above specifications, IRS may consider these as not processable and return them to you to be filed correctly. You may also be subjected to the penalty as mentioned in .07 above.

SEC. 17. PROCEDURES FOR PRINTING INTERNAL REVENUE SERVICE ENVELOPES

.01 Organizations are now permitted to produce substitute tax return envelopes. Use of substitute return envelopes that comply with the requirements set forth in this section will assist in delivery of mail by the Postal Service and facilitate internal sorting once the envelopes are received at the Internal Revenue Service Centers. The permanent five digit ZIP codes assigned to the ten service centers are listed below. These ZIP codes must be utilized when mailing returns to the prescribed service center:

ATLANTA GA 39901

KANSAS CITY MO 64999

AUSTIN TX 73301

PHILADELPHIA PA 19255

MEMPHIS TN 37501

ANDOVER MA 05501

CINCINNATI OH 45999

HOLTSVILLE NY 00501

OGDEN UT 84201

FRESNO CA 93888

.02 The sorting of returns by form type is accomplished by the preprinted bar codes on return envelopes that are included in each specific type of form or package mailed to the taxpayer. The 32 bit bar code located on the left and above the address on each envelope identifies the type of form that person is filing and assists the Service in consolidating like returns together for processing. Failure to use the envelopes furnished by the Service results in additional processing time and effort and possibly delays the timely deposit of funds, processing of returns and issuance of refund checks.

.03 The Internal Revenue Service will not furnish or sell bulk quantities of preprinted tax return envelopes to taxpayers or tax practitioners. A suitable alternative has been developed which will accommodate the sorting needs of both the IRS and the U.S. Postal Service. The new alternative is based on the use of ZIP+4 or 9 digit ZIP Codes for mailing various types of tax returns to the different area service centers. Essentially, the Postal Service will utilize the first five digits of a ZIP Code to sort and deliver the mail and IRS will utilize the last four digits to identify and sort the various form types into separate groups for processing. The list of add-on four digits or +4 portion of the 9 digit ZIP Codes with the related form designations is provided below and is to become a permanent part of the five digit service center ZIP codes shown above.

ZIP+FOUR	FORM/ PACKAGE
XXXXX-0001	1040A/EZ
XXXXX-0002	1040 Non-Bus
XXXXX-0003	1040 Bus & Farm
XXXXX-0005	941
XXXXX-0006	940
XXXXX-0007	942
XXXXX-0008	943
XXXXX-0011	1065
XXXXX-0012	1120
XXXXX-0013	1120S
XXXXX-0020	5500C
XXXXX-0024	5500EZ
XXXXX-0027	990
XXXXX-0031	2290

.04 The Internal Revenue Service will produce position/design sheets, OCR readable addresses with the appropriate ZIP+FOUR code(s) and Postnet bar code(s) as Reproduction Proofs. Position sheet specifications must be followed as to size, stock,

printing positions, clear areas and ink. Orders for each specific form/package ZIP code proof will be processed under Part A, Section 20 of this Revenue Procedure.

1 Any deviations from the specifications outlined on the position/design sheets must be approved in advance. Use of preparer company names, addresses and logos are permissible so long as prescribed clear areas are not invaded. Use of carbon based ink is essential for effective address and bar code reading. Envelope construction can be of side seam or diagonal seam design. Continuous pinfed construction is not desirable, but is permissible if the glued edge is at the top. This requirement is firm as mail opening equipment is designed to slice or otherwise open the bottom edge of each envelope.

.05 The above procedures or guidelines are written for the user having envelopes preprinted. Many practitioners may wish to have volumes of the different envelopes with differing ZIP Codes/form designations preprinted for reasons of low volume, warehousing, waste, etc. In this case, the practitioner can type or machine print the addresses with the appropriate ZIP Codes to accommodate sorting. If the requirements/guidelines outlined in this section cannot be met, then use of only the appropriate five digit service center ZIP Code is needed.

SEC. 18. PROCEDURE FOR SUBSTITUTE FORMS 5471

.01 *Instructions for Preparing Computer-Generated Substitute Form 5471.*

Paper substitutes for Form 5471 and the accompanying schedules that totally conform to the specifications contained in this procedure may be privately printed but must have prior approval and are subject to annual review from the Internal Revenue Service.

.02 Copies of the official form for the reporting year may be obtained from most Service offices. The Service provides only cut sheets of these forms. Continuous fan-fold/pin-fed forms are not provided.

.03 *Computer-Prepared Tax Forms.*

For filing purposes the Service will accept computer-prepared tax Forms 5471 filled in by a computer or by word processing equipment or similar automated equipment.

.04 *Computer-Generated Forms.*

For filing purposes, the Service will accept computer-generated versions of Form 5471 that are attached to individual and business income tax returns, provided the substitute and schedules meet the guidelines prescribed herein.

.05 *Combination of Manually-Prepared and Computer-Prepared/Generated Forms.*

For filing purposes, the Service will accept substitute Forms 5471 that contain a combination of computer-prepared/generated and filled in information.

.06 *Format Arrangement.*

The format of each substitute schedule or form must be an exact replica of the official form, following the format of the official schedule and form as to item captions, line references, line numbers, sequence, form arrangement and format, etc. Basically try to make the form look like the official one, with readability and consistency being primary factors. Use periods and/or other special characters to separate the various parts and sections of the form. All line numbers and items must be printed even though an amount is not entered on the line. The substitute form should be on the same size paper as the official forms and schedules.

.07 *Line Numbers.*

When a line on the official Form 5471 is designated by a number or a letter, that designation must be used on the substitute form. In addition, the reference code that is immediately before the data field must either be followed by a period or enclosed in parentheses. There also must be at least two blank spaces between the period or the right parenthesis and the first digit of the data field.

.08 *Filing Computer-Generated Substitute Forms 5471.*

Follow the same instructions as for filing official forms.

SEC. 19. ELECTRONICALLY FILED RETURNS

.01 Since the 1986 filing season, the Service has been accepting current processing year electronically filed refund returns. Electronic filing is a method by which qualified filers transmit tax return information directly to an IRS Center over telephone lines. Forms 1040, 1040A, and 1040EZ are transmitted in Form 1040 format.

1 The taxpayer signature does not appear on the electronic part of the tax return. The qualified electronic filer obtains it on Form 8453, U.S. Individual Income Tax Declaration for Electronic Filing. Forms W-2, W-2P, and W-2G are attached to the form as well as any other documents containing required signatures. In certain instances, a signed copy of the paper tax return will also be attached.

2 The electronically filed returns can be printed in hardcopy form via laster printer. The transmitted computer language information is extracted and printed on the appropriate form. The words "Electronic Return—Do Not Process" are printed across the top of page 1 of Form 1040. The hardcopy is a facsimile of the original return. No Service Center coding appears on the return. All coding is computer generated and appears on the output Code and Edit Sheet. The sheet is part of the hardcopy return and will be supplied for internal use only requests.

3 For specific information about electronic filing refer to Publication 1345, Specifications for Electronic Filing of Individual Income Tax Returns.

SEC. 20. FTD MAGNETIC TAPE PAYMENTS

.01 Revenue Procedure 89-48 (IRS Publication 1315) provides the requirements and instructions for reporting agents who submit Federal Tax Deposit (FTD) payment information on magnetic tape. Magnetic tape submissions for FTDs can be made for Forms 940, 941, 943, 720, CT-1, 990-PF, 990-T, 990-C, 1042, 1120, and Form 941 (Schedule A) Backup Withholding.

.02 Revenue Procedure 89-49 (Pub. 1374) provides the requirements and instructions for certain banks and fiduciaries to submit Form 1041-ES payments on magnetic tape through the Federal Tax Deposit (FTD) system.

SEC. 21. EFFECT ON OTHER DOCUMENTS

This revenue procedure supersedes Revenue Procedure 88-58, 1988-2 C.B. 728.

Exhibit A-1 (Preferred Format)

(Form 1040)

Department of the Treasury
Internal Revenue Service

Substitute Schedule A Itemized Deductions

OMB No. 1545-0074

1989

Attachment Sequence No. 07

Name(s) shown on Form 1040

Your social security number

Medical and Dental Expenses	1a	Prescription medicines and drugs, insulin, doctors, dentists, nurses, hospitals, medical insurance premiums you paid, etc.	1a		
	b	Other (list—include hearing aids, dentures, eyeglasses, transportation and lodging, etc.) ▶	1b		
	2	Add the amounts on lines 1a and 1b. Enter the total here	2		
	3	Multiply the amount on Form 1040, line 32, by 7.5% (.075)	3		
	4	Subtract line 3 from line 2. If zero or less, enter -0-. Total medical and dental ▶			4
Taxes You Paid	5	State and local income taxes	5		
	6	Real estate taxes	6		
	7	Other taxes (List—include personal property taxes) ▶	7		
	8	Add the amounts on lines 5 through 7. Enter the total here. Total taxes ▶			8
Interest You Paid	9a	Deductible home mortgage interest (from Form 1098) that you paid to financial institutions. Report deductible points on line 10.	9a		
	b	Other deductible home mortgage interest. (If paid to an individual, show that person's name and address) ▶	9b		
	10	Deductible points. (See Instructions for special rules.)	10		
	11	Deductible investment interest (see page 25)	11		
	12a	Personal interest you paid (see page 25) 12a			
	b	Multiply the amount on line 12a by 20% (.20). Enter the result	12b		
	13	Add the amounts on lines 9a through 11, and 12b. Enter the total here. Total interest ▶			13
Gifts to Charity	14	Contributions by cash or check. (If you gave $3,000 or more to any one organization, show to whom you gave and how much you gave.) ▶	14		
	15	Other than cash or check. (You must attach Form 8283 if over $500.)	15		
	16	Carryover from prior year	16		
	17	Add the amounts on lines 14 through 16. Enter the total here. Total contributions ▶			17
Casualty and Theft Losses	18	Casualty or theft loss(es) (attach Form 4684). (See page 26 of the Instructions.) ▶			18
Moving Expenses	19	Moving expenses (attach Form 3903 or 3903F). (See page 26 of the Instructions.) ▶			19
Job Expenses and Most Other Miscellaneous Deductions	20	Unreimbursed employee expenses—job travel, union dues, job education, etc. (You MUST attach Form 2106 in some cases. See Instructions.) ▶	20		
	21	Other expenses (investment, tax preparation, safe deposit box, etc.). List type and amount ▶	21		
	22	Add the amounts on lines 20 and 21. Enter the total.	22		
	23	Multiply the amount on Form 1040, line 32, by 2% (.02). Enter the result here	23		
	24	Subtract line 23 from line 22. Enter the result. If zero or less, enter -0- ▶			24
Other Miscellaneous Deductions	25	Other (from list on page 26 of Instructions). List ype and amount ▶ ▶			25
Total Itemized Deductions	26	Add the amounts on lines 4, 8, 13, 17, 18, 19, 24, and 25. Enter the total here. Then enter on Form 1040, line 34, the LARGER of this total or your standard deduction from page 17 of the Instructions ▶			26

For Paperwork Reduction Act Notice, see Form 1040 Instructions.

Schedule A (Form 1040) 1989

Exhibit A-2 (Acceptable Format)

(Form 1040)
Department of the Treasury
Internal Revenue Service

Substitute Schedule A
Itemized Deductions

OMB No. 1545-0074

1989

Attachment Sequence No. 07

Name(s) as shown on Form 1040 | Your social security number

Medical and Dental Expenses	1a	Prescription medicines and drugs, insulin, doctors, dentists, nurses, hospitals, medical insurance premiums you paid, etc.	1a		
	b	Other. (List—include hearing aids, dentures, eyeglasses, transportation and lodging, etc.) ▶	1b		
	2	Add the amounts on lines 1a and 1b. Enter the total here	2		
	3	Multiply the amount on Form 1040, line 32, by 7.5% (.075)	3		
	4	Subtract line 3 from line 2. If zero or less, enter -0-	4		
Taxes You Paid	5	State and local income taxes	5		
	6	Real estate taxes	6		
	7	Other taxes (List—include personal property taxes) ▶	7		
	8	Add the amounts on lines 5 through 7. Enter the total here	8		
Interest You Paid	9a	Deductible home mortgage interest (from Form 1098) that you paid to financial institutions. (Report deductible points on line 10	9a		
	b	Other deductible home mortgage interest. (If paid to an individual, show that person's name and address) ▶	9b		
	10	Deductible points. (See Instructions for special rules.)	10		
	11	Deductible investment interest (see page 25)	11		
	12a	Personal interest you paid (see page 24)	12a		
	b	Multiply the amount on line 12a by 20% (.20). Enter the result	12b		
	13	Add the amounts on lines 9a through 11, and 12b. Enter the total	13		
Gifts to Charity	14	Contributions by cash or check. (If you gave $3,000 or more to any one organization, show to whom you gave and how much you gave.) ▶	14		
	15	Other than cash or check. (You must attach Form 8283 if over $500.)	15		
	16	Carryover from prior year	16		
	17	Add the amounts on lines 14 through 16. Enter the total here	17		
Casualty and Theft Losses	18	Casualty or theft loss(es) (attach Form 4684). (See page 26 of the Instructions.)	18		
Moving Expenses	19	Moving expenses (attach Form 3903 or 3903F). (See page 26 of the Instructions.)	19		
Job Expenses and Most Other Miscellaneous Deductions	20	Unreimbursed employee expenses—job travel, union dues, job education, etc. (You MUST attach Form 2106 in some cases. See Instructions.) ▶	20		
	21	Other expenses (investment, tax preparation, safe deposit box, etc.). List type and amount ▶	21		
	22	Add the amounts on lines 20 and 21. Enter the total	22		
	23	Multiply the amount on Form 1040, line 32, by 2% (.02). Enter the result here	23		
	24	Subtract line 23 from line 22. Enter the result	24		
Other Miscellaneous Deductions	25	Other (from list on page 26 of Instructions). Enter type and amount	25		
Total Itemized Deductions	26	Add the amounts on lines 4, 8, 13, 17, 18, 19, 24, and 25. Enter the total here. Then enter on Form 1040, line 34, the LARGER of this total or your standard deduction from the Instructions	26		

Exhibit B-1 (Preferred Format)

Substitute Schedule B
Interest and Dividend Income

Schedule B (Form 1040) 1989 — OMB No. 1545-0074

Name(s) shown on Form 1040. (Do not enter name and social security number if shown on other side.) — Your social security number

Schedule B—Interest and Dividend Income

Attachment Sequence No. 08

Part I Interest Income

If you received more than $400 in taxable interest income, you must complete Parts I and III. List ALL interest received in Part I. If you received, as a nominee, interest that actually belongs to another person, or you received or paid accrued interest on securities transferred between interest payment dates, see page 27.

Interest Income		Amount
1 Interest income from seller-financed mortgages. (See Instructions and list name of payer.) ▶	1	
2 Other interest income. (List name of payer.) ▶	2	
3 Add the amounts on lines 1 and 2. Enter the total here and on Form 1040, line 8a. ▶	3	

Part II Dividend Income

If you received more than $400 in gross dividends and/or other distributions on stock, you must complete Parts II and III. If you received, as a nominee, dividends that actually belong to another person, see page 27.

Dividend Income		Amount
4 Dividend income. (List name of payer—include on this line capital gain distributions, nontaxable distributions, etc.) ▶	4	
5 Add the amounts on line 4. Enter the total here	5	
6 Capital gain distributions. Enter here and on Schedule D*	6	
7 Nontaxable distributions. (See the Instructions for Form 1040, line 9.)	7	
8 Add the amounts on lines 6 and 7. Enter the total here	8	
9 Subtract line 8 from line 5. Enter the result here and on Form 1040, line 9 ▶	9	

**If you received capital gain distributions but do not need Schedule D to report any other gains or losses, see the Instructions for Form 1040, lines 13 and 14.*

Part III Foreign Accounts and Foreign Trusts

If you received more than $400 of interest or dividends, OR if you had a foreign account or were a grantor of, or a transferor to, a foreign trust, you must answer both questions in Part III.	Yes	No
10a At any time during 1989, did you have an interest in or a signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)? (See page 27 of the Instructions for exceptions and filing requirements for Form TD F 90-22.1.)		
b If "Yes," enter the name of the foreign country ▶		
11 Were you the grantor of, or transferor to, a foreign trust which existed during 1989, whether or not you have any beneficial interest in it? If "Yes," you may have to file Form 3520, 3520-A, or 926		

For Paperwork Reduction Act Notice, see Form 1040 Instructions. — Schedule B (Form 1040) 1989

Exhibit B-2 (Acceptable Format)

(Form 1040)

Department of the Treasury
Internal Revenue Service

Substitute Schedule B
Interest and Dividend Income

OMB No. 1545-0074

1989

08

Name(s) as shown on Form 1040. (Do not enter name and social security number if shown on other side.)

Your social security number

Part I.—Interest Income

Interest Income		Federal	
1 Interest income from seller-financed mortgages. (See Instructions and list name of payer.) ▶	1		
2 Other interest income. (List name of payer.) ▶	2		
3 Add the amounts on lines 1 and 2. Enter the total here and on Form 1040, line 8a. ▶	3		

Part II Dividend Income

Dividend Income		Amount	
4 Dividend income. (List name of payer—include on this line capital gain distributions, nontaxable distributions, etc.) ▶	4		
5 Add the amounts on line 4. Enter the total here	5		
6 Capital gain distributions. Enter here and on Schedule D*	6		
7 Nontaxable distributions. (See the Instructions for Form 1040, line 9.)	7		
8 Add the amounts on lines 6 and 7. Enter the total here	8		
9 Subtract line 8 from line 5. Enter the result here and on Form 1040, line 9 ▶	9		

**If you received capital gain distributions but do not need Schedule D to report any other gains or losses, see the Instructions for Form 1040, lines 13 and 14.*

Part III.— Foreign Accounts and Foreign Trusts

	Yes	No
10 At any time during 1989, did you have an interest in or a signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)? (See page 27 of the Instructions for exceptions and filing requirements for Form TD F 90-22.1.)		
If "Yes," enter the name of the foreign country ▶		
11 Were you the grantor of, or transferor to, a foreign trust which existed during 1989, whether or not you have any beneficial interest in it? If "Yes," you may have to file Form 3520, 3520-A, or 926		

For Paperwork Reduction Act Notice, see Form 1040 Instructions.

Schedule B (Form 1040) 1989

EXHIBIT CG - A (SCHEDULE A)

SCHEDULE A (FORM 1040) ITEMIZED DEDUCTIONS 1989 * 07

OMB NO.1545-0074

JOHN Q. & MARY J. TAXPAYER SSN 000-00-0000

**********MEDICAL AND DENTAL EXPENSES**********

1A MEDICINE AND DRUGS,INSULIN
DOCTORS, DENTISTS, NURSES, HOSPITALS, ETC.....1A. 00,000.00

B OTHER (LIST)
1ST OR SEE STATEMENT XX.....1B.

2 ADD LINES 1A AND 1B ..... 2.

3 7.5% OF LINE 32, FORM 1040 ..... 3.

4 SUBTRACT LN. 3 FROM LN. 2 (OR ZERO) ..... 4.

**********TAXES PAID**********

5 STATE AND LOCAL INCOME.....5.

6 REAL ESTATE.....6.

7 OTHER (LIST) - 1ST OR SEE STATEMENT XX.....7.

8 ADD LINES 5 THRU 7.....8.

**********INTEREST PAID**********

9A HOME MORTGAGE INTEREST TO FINANCIAL INSTITUTIONS.....9A.

B OTHER HOME MORTGAGE INTEREST .....9B.
(LIST INDIVIDUAL'S NAME & ADDRESS)

10 DEDUCTIBLE POINTS.....10.

11 DEDUCTIBLE INVESTMENT INEREST.....11.

12A PERSONAL INTEREST PAID.....12A.

12B 20% OF LINE 12A.....12B.

13 ADD LINES 9A THRU 11 AND 12B.....13.

**********GIFTS TO CHARITY**********

14 CASH OR CHECK CONTRIBUTIONS.
(LIST ORG. & AMT IF $3000 OR MORE TO ONE ORGANIZATION)
1ST OR SEE STATEMENT XX.....14.

15 OTHER THAN CASH OR CHECK.....15.

16 CARRYOVER FROM PRIOR YEAR.....16.

17 ADD LINES 14 THRU 16.....17.

**********CASUALTY AND THEFT LOSSES**********

18 TOTAL CASUALTY/THEFT LOSSES FROM FORM 4684.....18.

**********MOVING EXPENSES**********

19 MOVING EXPENSES FROM FORM 3903.....19.

**********JOB EXPENSES & MOSTOTHER MISC. DEDUCTIONS**********

20 UNREIMBURSED EMPLOYEE BUSINESS EXP FROM FM 2106.....20.

21 OTHER (LIST)-1ST OR SEE STATEMENT XX.....21.

22 ADD LINES 20 AND 21.....22.

23 2% OF LINE 32, FORM 1040.....23.

24 SUBTRACT LN. 23 FROM LN. 22 (OR ZERO).....24.

**********OTHER MISC DEDUCTIONS**********

25 OTHER (LIST TYPE AND AMOUNT).....25.

**********TOTAL ITEMIZED DEDUCTIONS**********

26 ADD LINES 4, 8, 13, 17, 18, 19, 24, AND 25.
(ENTER ON FM 1040, LN. 34) 26. 000,000.00

****

FOR PAPERWORK REDUCTION ACT NOTICE, SEE SEPARATE INSTRUCTIONS R7199

EXHIBIT CG - B (SCHEDULE B)

SCHEDULE B (FORM 1040) INTEREST AND DIVIDEND INCOME 1989 *08
OMB NO. 1545-0074
JOHN Q. & MARY J. TAXPAYER SN 000-00-0000

****

PART I INTEREST INCOME

		AMOUNT
1.	INTEREST INCOME FROM SELLER FINANCED MORTGAGE...1.	00,000.00
	NAME OF PAYER	
2.	OTHER INTEREST INCOME (LIST).....2.	00,000.00
	(1ST PAYER) (2ND PAYER) (3RD PAYER) (4TH PAYER)	
3.	ADD LINES 1 AND 2 .....3.	00,000.00

****

PART II DIVIDEND INCOME

		AMOUNT
4.	DIVIDEND INCOME (LIST)	
	(1ST PAYER)(2ND PAYER)(3RD PAYER)(4TH PAYER)....4.	
5.	TOTAL OF LINE 4.....5.	00,000.00
6.	CAPITAL GAIN DISTRIBUTIONS.....6.	
7.	NONTAXABLE DISTRIBUTIONS.....7.	
8.	ADD LINES 6 AND 7.....8.	
9.	LINE 5 MINUS LINE 8 (ENTER ON FM 1040,LN.9).....9.	00,000.00

****

PART III FOREIGN ACCOUNTS AND FOREIGN TRUSTS

10A.	DURING 1989, DID YOU HAVE AN INTEREST IN OR A SIGNATURE OR OTHER AUTHORITY OVER A BANK ACCOUNT, SECURITIES ACCOUNT, OR OTHER FINANCIAL ACCOUNT IN A FOREIGN COUNTRY?	(ANS)
B.	IF YES, ENTER COUNTRY NAME:	
11.	WERE YOU THE GRANTOR OF OR TRANSFEROR TO A FOREIGN TRUST THAT EXISTED DURING 1989, WHETHER OR NOT YOU HAVE ANY BENEFICIAL INTEREST IN IT?	(ANS)

****

FOR PAPERWORK REDUCTION ACT NOTICE, SEE SEPARATE INSTRUCTIONS

EXHIBIT CG-1040 (1)

Form **1040** Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return

For the year Jan. -Dec. 31, 1988, or other tax year beginning

For the year Jan - Dec 31, 1988 OMB No 1545-0074

Use IRS label. Other-wise, please print or type. L A B E L H E R E

ame) Last name | Your social security number

ox, see instructions) | Spouse's social security number

For Privacy Act and Paperwork Reduction Act Notice, see instructions.

Presidential Election Campaign ▶ Do you want $1 to go to this fund? . . . . Yes No Note: Checking "yes" will not change
If joint return, does your spouse want $1 to go to fund? Yes No your tax or reduce your refund

Filing Status Check only one box.

1 ☐ Single
2 ☐ Married filing joint return (even if only one had income)
3 ☐ Married filing separate return. Enter spouse's social security no. above, full name here. ____
4 ☐ Head of household. If qualifying person is your child but not your dependent, enter this child's name here. ____
5 ☐ Qualifying widow(er) with dependent child (year spouse died ▶ 19). (see page 7 of instructions.)

Exemptions (See Instructions on page 8.)

6a ☐ Yourself If someone can claim you as a dependent, do not check the box on line 33b on page 2 . . . . . No. of boxes checked on 6a and 6b 1
b ☐ Spouse . . . . . No. of your children on 6c who:

c Dependents:

(1) Name (first, initial, and last name)	(2) Check if under age 5	(3) If age 1 or older, dependent's social security number	(4) Relationship	(5) No of months in your home

• lived with you . . .
• didn't live with you due to divorce.
No. of other listed dependents on 6c . .
If more than 6 dependents, see instructions on page 8.

d If your child didn't live with you but is claimed as your dependent under a pre-1985 agreement, check here. . ▶ ☐ Add numbers entered on lines above ▶

Income

PLEASE ATTACH COPY B OF YOUR W-2, W-2G & W-2P HERE.

IF YOU DO NOT HAVE A W-2, SEE PAGE 6 OF INSTRUCTIONS.

PLEASE ATTACH CHECK OR MONEY ORDER HERE.

	b	TAX-EXEMPT interest income. DON'T incl	
9		Dividend income (also attach Schedule	
10		Taxable refunds of state and local inc	
11		Alimony received.	
12		Business income or (loss)(attach Sched	
13		Capital gain or (loss)(attach Schedule	
14		Capital gain distributions not reporte	
15		Other gains or (losses)(attach Form 47	
16a		Total IRA distributions. . 16a	
17a		Total pensions & annuities 17a	
18		Rents, royalties, partnerships, estate	
19		Farm income or (loss)(attach Schedule	
20		Unemployment compensation (insurance)	
21a		Social security benefits (see page 13)	
	b	Taxable amount, if any, from the works	
22		Other inc. ____	
23		Add amts shown in far right column for	

Adjustments to Income (SEE INSTRUCTIONS ON PAGE 13.)

24		Reinbursed empl. bus. expenses Form 21	
25a		Your IRA deduction, from worksheet on	
	b	Spouse's IRA deduction, from worksheet	
26		Self-employment health insurance deduc	
27		Keogh retirement plan/self-employment	
28		Penalty on early withdrawal of savings	
29		Alimony paid (recpts. name: ____ & social security no. ____	
30		Add 24 to 29.	

Adjusted Gross Income

31		Subtract line 30 from line 23. This is	
		If less than $18,576 and a child live	

is claimed as your dependent under . . . . . ▶ ☐
o complete line 36) 7
m(s) W-2) 8a
hedule B if over $400) 8b
nclude on line 8a . . 8b
if over $400) 9
me taxes, if any, from worksheet 10
. 11
uld-C) 12
D) 13
on line 13 (see page 11) 14
'87) 15
16b Taxable amount 16b
17b Taxable amount 17b
, trusts, etc. (attach Schedule E) 18
F) 19
see page 12) 20
. . . . . 21a
eet on page 12 . . . . . 21b
e page 12) ____ 22
for lines 7-22. This is your total income ▶ 23

rom Form 2106	24	
ksheet	25a	
e worksheet	25b	
n	26	
SEP deduction . . .	27	
. . . . .	28	
___)	29	

total adjustments . . . . . ▶ 30
your adjusted gross income. If this line with you, see "Earned Income Credit" e. If you want the IRS to figure your . . . . . ▶ 31

Form 1040 (19

EXHIBIT CG-1040 (2)

Form 1040 (1988) Page 2

Tax Computation	32	Amount from line 31 (adjusted gross income)	32	
	33a	Check if ☐ You were 65 or over ☐ Blind; ☐ Sp Add the number of boxes checked and enter the tota	33a	
	b	If someone (such as your parent) can claim you as	33b ☐	
	c	If you are married filing a separate return and yo or you are a dual-status alien, see page 16 and ch	33c ☐	
	34	Enter the Larger of: Your standard deduction (from page 1 Your itemized deduction (from Sched If you itemize, attach Schedule A an	34	
	35	Subtract line 34 from line 32. Enter the result he	35	
	36	Multiply $1,950 by the total number of exemptions	36	
	37	Taxable income. Sub ln 36 from ln 35. Enter the re	37	
		Caution: If under age 14 & have more than $1,000 o and see page 16 to see if you have to use Form 861		
	38	Enter tax. Check if from ☐ Tax Table, ☐ Tax Ra	38	
	39	Additional taxes (see page 17). Check if from ☐	39	
	40	Add lines 38 and 39. Enter the total	40	
Credits (See Instructions on page 17.)	41	Credit for child & dep care expenses (attach Form	41	
	42	Credit for the elderly or the disabled (attach Sch	42	
	43	Foreign tax credit (attach Form 1116)	43	
	44	General business credit. Check if from: ☐ Form 3800, or ☐ Form _____	44	
	45	Credit for prior year minimum tax (attach Form 88	45	
	46	Add lines 41 through 45. Enter the total	46	
	47	Subtract line 46 from line 40. Enter the result	47	
Other Taxes (Including Advance EIC Payments)	48	Self-employment tax (attach Schedule SE)	48	
	49	Alternative minimum tax (attach Form 6251)	49	
	50	Recapture taxes (see page 17). Check if from: ☐	50	
	51	Social security tax on tip income not reported to		
	52	Tax on an IRA or a qualified retirement plan (att		
	53	Add lines 47 through 52. This is your total tax	53	$ 0.00
Payments Attach Forms W-2, W-2G, and W-2P to front.	54	Federal income tax withheld (If any is from Form(s) 1099, che	54	
	55	1988 estimated tax payments and amount applied from 198	55	
	56	Earned income credit	56	
	57	Amount paid with Form 4868 (extension request)	57	
	58	Excess social security tax and RRTA tax withheld	58	
	59	Credit for Federal tax on fuels (attach Form 4136)	59	
	60	Regulated investment company credit (attach Form 243	60	
	61	Add lines 54 through 60. These are your total payme	61	$ 0.00
Refund or Amount You Owe	62	If line 61 is larger than line 53, enter amount OVERPAID	62	
	63	Amount of line 62 to be REFUNDED TO YOU	63	
	64	Amount of line 62 to be applied to your 1989 estimated	64	
	65	If line 53 is larger than line 61, enter AMOUNT YOU O amount payable to "Internal Revenue Service." Write y number, and "1988 Form 1040" on it	65	
		Check ▶ ☐ if Form 2210 (2210F) is attached. See page 2		

Please Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than the taxpayer) is based on all information of which he has any knowledge.

Your signature ▶ _____ Date _____ Your occupation _____

Spouse's signature (if joint return, BOTH must sign) ▶ _____ Date _____ Spouse's occupation _____

Paid Preparer's Use Only

Preparer's signature ▶ _____ Date _____ Check if self-employed ☐ Preparer's S S No. _____

Firm's name (or yours if self-employed) and address ▶ _____ E. I. No. _____

ZIP code _____

26 CFR 601.602: Tax forms and instructions. (Also Part 1, Sections 3402, 6001, 6361; 31.3402(b)-1, 31.3402(f)(5)-1, 31.3402(h)(4)-1, 31.3402(p)-1, 31.6001-5.)

Rev. Proc. 90-9

CONTENTS

PART A. GENERAL

SECTION 1. PURPOSE
SECTION 2. NATURE OF CHANGES
SECTION 3. APPLICATION TO FILE ON MAGNETIC MEDIA
SECTION 4. FILING DATES
SECTION 5. FILING OF MAGNETIC MEDIA REPORTS
SECTION 6. PROCESSING OF MAGNETIC MEDIA RETURNS
SECTION 7. EFFECT ON PAPER DOCUMENTS
SECTION 8. HOW TO CONTACT THE MARTINSBURG COMPUTING CENTER
SECTION 9. DEFINITION OF TERMS

PART B. MAGNETIC TAPE SPECIFICATIONS

SECTION 1. GENERAL
SECTION 2. LABEL CONVENTIONS
SECTION 3. RECORD LENGTH AND BLOCKING
SECTION 4. EFFECT ON OTHER DOCUMENTS

PART A. GENERAL

SECTION 1. PURPOSE

.01 The purpose of this Revenue Procedure is to update Rev. Proc. 87-47, 1987-2 C.B. 635, (Publication 1245), which outlines the requirements and conditions for submitting certain Forms W-4, Employee's Withholding Allowance Certificate, on magnetic tape to the Internal Revenue Service (IRS), Martinsburg Computing Center (MCC).

.02 Employers may submit all information on magnetic tape; or a combination of tape records and paper documents is acceptable, provided there is no duplication or omission of documents.

.03 Employers are required to send to IRS quarterly copies of all Forms W-4 received during the quarter from employees still employed at the end of the quarter who claim the following:

(a) Eleven (11) or more withholding allowances, or

(b) Exempt status and who are expected to earn more than $200 a week.

Employers are not required to send any others unless notified by IRS in writing to do so. Employers are required also to notify certain employees not having income tax withheld that they may be eligible for a tax refund because of the Earned Income Credit (EIC) since the amount of EIC that exceeds the tax liability is refunded. Employers can notify these employees by giving them Notice 797 with their Forms W-2 (or within one week before or after giving the W-2).

SEC. 2. NATURE OF CHANGES

.01 For Tax Year 1990, the following changes have been included in this revenue procedure:

(a) All references to the National Computer Center have been changed to the Martinsburg Computing Center to reflect the name change of October 1, 1988.

(b) The "Allowances" field, tape positions 154-156, has been clarified to reflect that the necessary number of allowances that require filing is eleven (11) or more.

(c) The "W-4 Date" field tape positions 164-169, has been changed to concur with the appropriate line of the paper form. Any reference to line 6C on the paper Form W-4 has been changed to line 6.

(d) Additional territories and the corresponding codes have been added to the list of state codes for the convenience of the filers.

(e) Added a section on "Contacting the Martinsburg Computing Center"—Part A, Sec. 8.

(f) Deleted section on "Additional Information."

SEC. 3. APPLICATION TO FILE ON MAGNETIC MEDIA

.01 Employers or transmitters who wish to file on magnetic tape must submit a Form 4419, Application for Filing Information Returns on Magnetic Media. A copy of the form is included in this publication. Instructions for its completion are on the reverse of the form.

.02 Magnetic tape returns may not be filed with IRS until authorization to file is received. Requests will be approved or disapproved within 30 days of receipt.

.03 Only applications of those employers or transmitters whose files meet the specifications in Part B, Sec. 1, will be approved.

.04 Once authorization to file on magnetic tape has been granted, a five-character alpha/numeric Transmitter Control Code (TCC) will be assigned. Approval will continue in effect in succeeding years provided the requirements of the current revenue procedure are met and there are no equipment changes by the employer and transmitter. Although a TCC may have been already assigned to a transmitter for the filing of information returns other than W-4, the W-4 program requires a separate TCC of its own. This TCC must appear on all transmittal forms submitted with magnetic media files as well as other correspondence. The TCC will also be coded into positions 315-319 of the W-4 magnetic tape record. (See Part B, Sec. 3.)

.05 New applications are required whenever:

(a) You discontinue filing on magnetic media for a year, in which case your TCC may have been reassigned.

(b) You have used a service agency in the past to prepare your files but now have computer equipment compatible with that of IRS, in which case you must request your own TCC.

.06 It is necessary to notify MCC of software changes that would affect the characteristics of the magnetic media submission.

If any of the above conditions apply to you, contact IRS/MCC. For the address and telephone number of IRS/MCC, refer to Part A, Sec. 8.

SEC. 4. FILING DATES

Magnetic tape reporting of Forms W-4 to IRS must be at least quarterly (monthly reporting is encouraged) following the quarter end dates:

Period Covered	*Due Date*
January 1 thru March 31	April 30
April 1 thru June 30	July 31
July 1 thru September 30	October 31
October 1 thru December 31	January 31

SEC. 5. FILING OF MAGNETIC MEDIA REPORTS

.01 A Magnetic Tape Reporting (MTR) package, which includes the current revenue procedure, packaging, shipping, and mailing instructions, and the necessary transmittals and labels, will automatically be mailed to approved filers each year.

.02 If the employer chooses to file paper copies (originals are for your records), then a cover letter which includes the employer's name, address, employer identification number (EIN), and the number of Forms W-4 being submitted must be sent to the service center where Forms 941 are filed. The paper copies may also be submitted as an attachment to Form 941.

If the employer chooses to file on magnetic media, then a Form 6466, Transmittal of Magnetic Tape of Form W-4, Employee's Withholding Allowance Certificate, must be sent to the IRS Martinsburg Computing Center (MCC) as prescribed in Part A, Sec. 3.

NOTE: MCC DOES NOT PROCESS ANY PAPER RETURNS. PAPER RETURNS MUST BE FILED WITH THE APPROPRIATE SERVICE CENTER.

.03 The affidavit appearing on Form 6466 should be signed by the employer(s); however, the transmitter, service bureau, or disbursing agent may sign the affidavit on behalf of the employer(s) if all the following conditions are met:

(a) The agent has the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under the state law.

(b) The agent signs the form and adds the caption "For: (name of employer or other person required to file)."

.04 Although a duly authorized agent signs the affidavit, the employer(s) is held responsible for the accuracy of Forms W-4 contained on magnetic media.

.05 DO NOT REPORT THE SAME INFORMATION ON PAPER DOCUMENTS THAT YOU REPORT ON MAGNETIC TAPE. If you report part of your returns on paper and part on magnetic tape, be sure that duplicate returns are not included on both.

.06 Before submitting your magnetic tape file, include the following:

(a) A signed Form 6466.

(b) A Form 6467 if you submit data for multiple employers.

(c) The magnetic tape with an external identifying label (Form 6469).

(d) On the outside of the shipping container, include a Form 4801, or a substitute for the form which reads "DELIVER UNOPENED TO TAPE LIBRARY—MAGNETIC MEDIA REPORTING—BOX ___ OF ___." If there is only one container, mark the outside as Box 1 of 1. For multiple containers, include the sequence (e.g., Box 1 of 3, 2 of 3, 3 of 3).

SEC. 6. PROCESSING OF MAGNETIC MEDIA RETURNS

.01 THE MAGNETIC TAPE SPECIFICATIONS CONTAINED IN PART B OF THIS REVENUE PROCEDURE MUST BE STRICTLY ADHERED TO. If files are unprocessable, they will be returned to you for replacement and resubmission of tapes, or submission of paper Forms W-4. Replacement files must be resubmitted to IRS/MCC within 30 days of the date of the notice. The data should be identified as replacement data by writing, typing, or printing "Magnetic Media Replacement" on the external label used on the magnetic tape, on the Forms 6466/6467, and any other label used in the magnetic tape shipment.

.02 IRS will process the information from the original tapes and will return the original tapes to the employer. Normally tapes will be returned within three months of the date of receipt.

.03 IRS cannot accept any Cash-On-Delivery (COD) or Charged-to-IRS shipments of reportable tax information that an individual or organization is legally required to submit. Because of the high volume of data received and shipping cost involved, special shipping containers will not be returned to you.

SEC. 7. EFFECT ON PAPER DOCUMENTS

.01 Magnetic tape reporting to IRS eliminates the need to submit copies of paper Forms W-4. However, employers must maintain the original Forms W-4, either on magnetic media or on paper for their records; or they must have the ability to reconstruct the data for four (4) years.

.02 If part of the Forms W-4 are reported on magnetic tape and the remainder are reported on paper forms, the paper returns must be filed on the prescribed forms as stated in Part A, Sec. 5.02, with the appropriate service center.

SEC. 8. HOW TO CONTACT THE MARTINSBURG COMPUTING CENTER

.01 Magnetic media covered under this revenue procedure and all requests for IRS magnetic media related publications, information and forms must be directed to the following addresses:

If by Postal Service:
IRS-Martinsburg Computing Center
Post Office Box 1359
Martinsburg, WV 25401-1359

If by Land Carrier:
IRS-Martinsburg Computing Center
Magnetic Media Reporting Section
Route 9 & Needy Road
Martinsburg, WV 25401

.02 Hours of operation are 8:30 a.m. until 6 p.m. Eastern Time Zone. The telephone number is (304) 263-8700.

.03 Requests for paper returns, publications, or forms not related to magnetic media processing should be requested by calling the IRS toll-free number in your area.

SEC. 9. DEFINITION OF TERMS

Employer	Generally, an employer is a person or organization for whom a worker performs a service as an employee. The employer usually gives the worker the tools and place to work and has the right to hire the worker. A person or organization paying wages to a former employee after the work ends is also considered an employer.
Employee	One employed by another usually for wages or salary and in a position below the executive level.
Independent Contractor	People in business for themselves are not employees. For example, doctors, lawyers, veterinarians, construction contractors, and others in an independent trade in which they offer their services to the public are usually not employees, but are independent contractors.
Common Law Employees	Anyone who performs services is an employee if you, as an employer, can control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the legal right to control the method and result of the services.
Statutory Employee	If someone who works for you is not an employee under the common law rules explained above, do not withhold Federal income tax from his or her pay. While the person may not be a common law employee, he/she is considered an employee for social security purposes. (See Circular E, Employer's Tax Guide, for a more thorough explanation.)
b	Denotes a blank position. Enter blank(s) when this symbol is used ("b"). This notation appears throughout the record descriptions.
EIN	Employer Identification Number that has been assigned by IRS.
File	For purposes of this procedure, a file consists of all magnetic tape records submitted by an employer or transmitter.
Special Character	Any character that is not a numeral, a letter, or a blank.
SSA	Social Security Administration.
SSN	Social Security Number.
Taxpayer Identification Number (TIN)	May be either an EIN or SSN.
Transmitter	Person or organization preparing magnetic tape file(s).
Transmitter Control Code (TCC)	A five-character alpha/numeric assigned by IRS to the transmitter prior to actual filing on magnetic media. This number is inserted in Positions 315-319 of your files and must be present before the file can be processed. An application Form 4419 must be filed with IRS to receive this number.
Invalid W-4	Any unauthorized changes or additions to Form W-4 makes it invalid. (See Page 7, Circular E, Employer's Tax Guide.)

PART B. MAGNETIC TAPE SPECIFICATIONS

SECTION 1. GENERAL

.01 These specifications prescribe the required format and content of the records to be included in the file, but not the methods or equipment to be used in their preparation. If you are unable to use the special characters specified in this revenue procedure, please contact us to let us know what characters you will be using as substitutes. Usually, IRS will be able to process any compatible tape file. To be compatible, tape files must meet all the following specifications:

(a) Type of tape—1/2 inch Mylar base, oxide coated

(b) Interrecord Gap:

(1) .6-inch for 800 or 1600 BPI (bits per inch) density 9 track

(2) .3-inch for 6250 BPI density 9 track

(c) Recording Code—9 track ASCII (American Standard Coded Information Interchange) with:

(1) Odd parity, and

(2) A density of 800, 1600, or 6250 BPI.

.02 Conversion facilities are currently available for the following tapes:

Recording Code—9 track EBCDIC (Extended Binary Coded Decimal Interchange Code) with:

(1) Odd parity, and

(2) A density of 800, 1600, or 6250 BPI.

.03 The employer or the transmitter must affix an external label to each tape with the following information:

(a) Name of transmitter

(b) Number of data records on that reel

(c) Recording Code (ASCII, EBCDIC, or BCD)

(d) Density (800, 1600, or 6250 BPI)

(e) Track (9)

(f) Parity (odd)

(g) Manufacturer and model of main frame and tape drives

(h) Sequence number of reel and total number of reels in the file (e.g., 1 of 3, 2 of 3, etc.)

.04 All records, including Header and Trailer Labels (if used) must be transmitted using the same density.

.05 Do not submit an employee W–4 record without the required employer identification information. Every record must contain both employee and employer data.

SEC. 2. LABEL CONVENTIONS

.01 Header Labels, Trailer Labels, Record Marks, and Tape Marks are all optional. They may be used as required by the transmitter's equipment or programming. If used, they must conform to the following standards:

(a) Header Labels:

(1) Transmitters may use standard headers, provided they begin with 1HDR, HDR1, VOL1 or VOL2.

(2) Header Labels may not exceed 80 characters in length.

(b) Trailer Labels:

(1) Standard Trailer Labels may be used provided that they begin with 1EOR, 1EOF, EOR1, or EOF1.

(2) Trailer Labels may not exceed 80 characters in length.

(c) Record Marks:

(1) Special character used to separate blocked records on tape.

(2) Can be written only at the end of a record or block.

(3) All records are of uniform length; therefore, record marks are not necessary on this file.

(d) Tape Marks:

(1) Used to signify the physical end of the recording on tape.

(2) May follow the Header Label and precede and/or follow the Trailer Label.

SEC. 3. RECORD LENGTH AND BLOCKING

.01 Tape records prescribed in the specifications may be blocked or unblocked, subject to the following:

(a) All data records are a fixed length of 320 positions.

(b) All records may be blocked, except Header and Trailer Labels.

(c) If blocking is used (more than one record per block), the desired blocking factor is ten (10) records per block. At no time may a block contain more than 3,200 characters; however, a smaller block size may be used if necessary. If sufficient records are not available for a full block, the remainder should be either "padded" with 9s to fill all unused positions or truncated. Do not pad the block with blanks or create blank records.

RECORD NAME: W–4 MAGNETIC TAPE RECORD

Tape Position	Field Title	Length	Description and Remarks
1–9	Employee Social Security Number (SSN)	9	REQUIRED. Must be the valid 9-digit number assigned to the employee. DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROES.
10–44	Employee Name Line 1	35	REQUIRED. Enter the name of the employee whose SSN appears in tape positions 1–9. Enter the complete name in the following order: first name, middle name (if present), surname, and suffix (if present). (Use initials for the first and middle names where necessary to insure that the entire employee surname fits in tape positions 10–44.) If fewer than 35 characters are required, left-justify and fill unused positions with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, HYPHENS, BLANKS, A MINIMUM OF ONE AND A MAXIMUM OF TWO CARETS (<). (1) A blank must be surrounded by alphas or continued to the end of the field (e.g., ab. . .b, ab a). (2) Hyphens must be surrounded by alphas and must never occur in the first position of a name unless immediately followed by a caret. A hyphen in the first position is to identify an employee with surname only. (3) A caret is used to define an internal name control. It must immediately precede the employee surname in place of the blank. A second caret is used to separate a suffix from the surname (e.g., JOHN J< BLACK; BILL<OAK<JR; AMY FERN< BROWN<MD).

Tape Position	Field Title	Length	Description and Remarks
45–79	Employee Name Line 2	35	Optional. This line is designated for an "in care of" (c/o) situation. Left-justify and fill unused positions with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSANDS, HYPHENS, SLASHES, AND PERCENTS (%). Hyphens and slashes must be surrounded by alphas or numerics; ampersands must be surrounded by blanks; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., aბ. . .ბ, aბa). **Note:** The same exceptions apply as set forth in "Employee Name Line 1" plus the use of a percent sign (%) is not valid—use c/o, if necessary.
80–114	Employee Street Address	35	REQUIRED. Enter street address of employee. Left-justify and fill unused positions with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSANDS, HYPHENS, AND SLASHES. Position one is an alpha or numeric; hyphens and slashes must be surrounded by alphas or numerics; ampersands must be surrounded by blanks; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., aბ. . .ბ, aბa).
115–139	Employee City	25	REQUIRED. Enter city of employee. Left-justify and fill unused positions with blanks. If foreign address, enter city and country. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AND HYPHENS. Position one is an alpha or numeric; hyphens must be surrounded by alphas or numerics; ampersands must be surrounded by blanks; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., aბ. . .ბ, aბa).
140–141	Employee State	2	REQUIRED. Enter the two-character state code of employee—must be one of the following: *State* — *Code* Alabama — AL Alaska — AK Arizona — AZ Arkansas — AR California — CA Colorado — CO Connecticut — CT Delaware — DE District of Columbia — DC Florida — FL Georgia — GA Hawaii — HI Idaho — ID Illinois — IL Indiana — IN Iowa — IA Kansas — KS Kentucky — KY Louisiana — LA Maine — ME Maryland — MD Massachusetts — MA Michigan — MI Minnesota — MN

Tape Position	Field Title	Length	Description and Remarks
			State — *Code* Mississippi — MS Missouri — MO Montana — MT Nebraska — NE Nevada — NV New Hampshire — NH New Jersey — NJ New Mexico — NM New York — NY North Carolina — NC North Dakota — ND Ohio — OH Oklahoma — OK Oregon — OR Pennsylvania — PA Rhode Island — RI South Carolina — SC South Dakota — SD Tennessee — TN Texas — TX Utah — UT Vermont — VT Virginia — VA Washington — WA West Virginia — WV Wisconsin — WI Wyoming — WY
142–150	Employee ZIP Code	9	REQUIRED. Enter nine-digit ZIP Code of employee. Fill with blanks if unavailable. ALLOWABLE CHARACTERS ARE NINE (9) NUMERICS OR NINE (9) BLANKS. IF YOU ONLY HAVE FIVE (5) DIGITS AVAILABLE, LEFT-JUSTIFY AND ZERO FILL. Blank fill only if you are unable to ascertain the employee's ZIP Code.
151	Marital Status	1	REQUIRED. Enter appropriate code from the table below: *Marital Status Designated* — *Code* Single — S Married — M Married, withhold at single rate — W No marital status designated — A
152	Exempt Status	1	REQUIRED. Enter "E" if employee claims exempt status; otherwise, blank.
153	Student Status	1	REQUIRED. If full-time student status is claimed, enter the alpha "Y"; if not, or no entry, enter blank.
154–156	Allowances	3	REQUIRED. Must be a three (3) digit numeric field corresponding to the number of allowances claimed by employee. (It is necessary to file this W-4 with IRS if the number of allowances is eleven (11) or more and exempt status is claimed.) Field must be right justified and zero filled. If no entry, or employee claimed exempt status, enter blanks.
157–163	Additional Amount of Withholding	7	REQUIRED. Enter numerics only. Enter the additional amount of withholding, if any, the employee wants deducted from each pay. Field is dollars and cents. Right-justify and zero fill. Do not enter dollar signs, commas, decimal points, or negative numbers. If no entry, zero-fill.

Tape Position	Field Title	Length	Description and Remarks
164–169	W–4 Date	6	REQUIRED. Enter date located on signature line of W–4. If no date entered, generate current system date. Format as MMDDYY where MM = 01–12, DD = 01–31, and YY = 90 (or subsequent years). Exempt Status W–4 (1983 and subsequent)—Compare "year effective date" on Line 6 to signature date. If year entered on Line 6 is later than signature date, use W–4 date as a 01/01 receipt for subsequent calendar year (e.g., Line 6 of Form W–4 shows an exempt status date of 1989 but signature date is 10/30/88, use 01/01/89 as Form W–4 date.)
170–178	Employer Identification Number	9	REQUIRED. The 9-digit number assigned to the employer by IRS. DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROES.
179–213	Employer Name Line 1	35	REQUIRED. Enter the name of the employer as it appears on employment tax forms (e.g., Form 941). Any extraneous information must be deleted from this name line. Left-justify and fill with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSANDS, HYPHENS AND SLASHES. Position one is an alpha or numeric; hyphens and slashes must be surrounded by alphas or numerics; ampersands must be surrounded by blanks; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., a♁. . .♁, a♁a).
214–247	Employer Name Line 2	34	Optional. If the employer name requires more space than is available in Employer Name Line 1, enter the remaining portion of the name in this field. Left-justify and fill with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSANDS, HYPHENS, SLASHES, AND PERCENTS (%). Position one is an alpha or numeric; hyphens and slashes must be surrounded by alphas or numerics; ampersands must be surrounded by blanks; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., a♁. . .♁, a♁a).
248–282	Employer Street	34	REQUIRED. Enter street address of employer. Left-justify and fill unused positions with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSANDS, HYPHENS, AND SLASHES. Position one is an alpha or numeric; hyphens and slashes are surrounded by alphas—ampersands are surrounded by blanks.
283–307	Employer City	25	REQUIRED. Enter city of employer. Left-justify and fill unused positions with blanks. If foreign address, enter city and country. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AND HYPHENS. Position one is an alpha or numeric; hyphens and slashes must be surrounded by alphas or numerics; ampersands must be surrounded by blanks; blanks must be surrounded by alphas or numerics or continued to the end of the field (e.g., a♁...♁, a♁a).
308–309	Employer State	2	REQUIRED. Enter State Code of employer. Must be one of the state abbreviations shown in the state abbreviation table for Employee State (tape positions 140–141).
310–314	Employer ZIP Code	5	REQUIRED. Enter ZIP Code of Employer. ALLOWABLE CHARACTERS ARE FIVE (5) NUMERICS OR FIVE (5) BLANKS. Enter first five (5) digits if more than five digits are present. Blank fill only if you are unable to ascertain Employer's ZIP Code.

RECORD NAME: W-4 MAGNETIC TAPE RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
315-319	Transmitter Control Code	5	REQUIRED. Enter 5-character Transmitter Control Code (TCC) assigned by IRS.
320	"BLANK" Representation	1	REQUIRED. Enter character used to represent a blank.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 87-47, 1987-2 C.B. 635, is superseded.

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of current tax liability
(Also Part I, Sections 38, 47, 48; 1.38-1, 1.47-1, 1.48-1.)

Rev. Proc. 90-10

SECTION 1. PURPOSE

This revenue procedure makes available an election to United States owners of intermodal cargo containers that are used predominantly outside the United States during the taxable year. Taxpayers may apply the Table set out in section 4.03 of this revenue procedure, subject to the limitation set out in section 4.06, to determine: (a) what portion of the containers placed in service in a taxable year will be treated as meeting the exception in section 48(a)(2)(B)(v) of the Code for purposes of determining depreciation under section 168(a) or section 168(g) throughout their recovery period, and (b) what portion of a taxpayer's containers placed in service in a taxable year meets the exception or continues to meet the exception for the investment tax credit under section 38(b) for the taxable years the credit was in effect, or to which the recapture provisions of section 47 could apply. The election provided in this revenue procedure is also available for purposes of depreciation systems in effect for cargo containers placed in service prior to January 1, 1987 (for example, the facts and circumstances method of depreciation under section 167(a), the asset depreciation range system of section 167(m) and the accelerated cost recovery system of section 168 of the 1954 Code). See section 3 of this procedure for a description of those taxpayers eligible to make the election.

SEC. 2. BACKGROUND

.01 Section 168(a) of the Code requires taxpayers to determine the depreciation deduction allowed by section 167(a) by using the applicable depreciation method, the applicable recovery period, and the applicable convention.

.02 Section 168(g)(1)(A) of the Code requires taxpayers to depreciate under the alternative depreciation system the cost of any tangible property used predominantly outside the United States during the taxable year. To determine whether property is used predominantly outside the United States, section 168(g)(4) applies the rules under section 48(a)(2) (including the exceptions in section 48(a)(2)(B)).

.03 Section 48(a)(2)(A) of the Code denies eligibility for the investment tax credit to property used predominantly outside the United States. Section 1.47-2(b)(1) of the regulations indicates that this requirement must be met each taxable year during the applicable recovery or recapture period. Under section 48(a)(2)(B)(v), however, a container used predominantly outside the United States nevertheless qualifies for the investment tax credit if it is owned by a United States person and is used in the transportation of property to and from the United States.

.04 Rev. Rul. 90-9, page 460, this Bulletin, concludes that a taxpayer must depreciate under the alternative depreciation system of section 168(g) of the Code the cost of an intermodal cargo container used predominantly outside the United States during the taxable year if the taxpayer cannot document that the container was used substantially in the direct transportation of property to or from the United States during the taxable year. However, in lieu of records tracing individual cargo containers, the taxpayer may be eligible to use the election set out in section 4 of this revenue procedure.

SEC. 3. SCOPE

.01 A taxpayer described in this section is eligible to make the election to use the Table set out in section 4.03 of this revenue procedure if the taxpayer is a United States person and maintained records that identify the cost or other basis and the placed-in-service year and any subsequent retirement or other disposition of its cargo containers. A taxpayer is eligible to make the election without regard to whether it has maintained sufficient records to trace the usage of its cargo containers as required in Rev. Rul. 90-9, supra.

.02 An intermodal cargo container described by this section 3 is a reusable box of standardized dimensions and performance characteristics that is used for the transportation of goods and constructed to meet size and safety standards set forth in international agreements to which the United States is a party. *See, generally*, S. Rep. No. 552, 95th Cong., 1st Sess. 2-3 (1977), 1977 U.S. CODE CONG. & ADMIN. NEWS (92 Stat.) 4017, 4018-19 (concerning the International Safe Container Act, 46 U.S.C. App. Sections 1501-07, which implements the International Safe Container Convention (Geneva, Dec. 2, 1972)).

.03 Intermodal cargo containers are described in this section 3 if they are part of a mass or group of cargo containers (not necessarily homogeneous), and with respect to which separate tracing is usually impracticable because: (a) it is disproportionately expensive when compared to the value of the advantage of the tax benefits permitted under section 38 or 168(a) of the Code, (b) it is dispro-

portionately difficult given numerous worldwide routes with multiple terminuses, or (c) it involves the participation of persons other than the taxpayer when the containers are under the physical control of the other persons.

SEC. 4. ELECTION

.01 With regard to intermodal cargo containers described in section 3, a taxpayer may irrevocably elect to use the Table set out in section 4.03 to determine the percentage of the bases of all such containers placed in service during the taxable year that qualifies for the exception in section 48(a)(2)(B)(v) of the Code for the year for which the election is made ("the election year") and for all relevant subsequent taxable years. Thus, the election applies to the group of cargo containers placed in service in the election year for purposes of determining the level of continuing satisfaction of the exception in subsequent taxable years. The election for any given taxable year does not apply to containers placed in service in any other taxable year.

.02 In order to determine the number of its containers described in section 3.03 that will be considered to be used to transport property to or from the United States during the taxable year, a taxpayer making the irrevocable election in section 4.01 is permitted to use the Table set out in section 4.03 in the following manner. All containers described in section 3.02 and placed in service during the election year will be considered to be a single account. The portion of that account (after adjustment for retirements or other dispositions) that is considered to satisfy section 48(a)(2)(B)(v) of the Code in any taxable year, including subsequent taxable years, is equal to the percentage shown in section 4.03 reflecting industry-wide usage of cargo containers. The use of the Table may not be combined with actual tracing of other qualified intermodal cargo containers placed in service during the election year.

.03 The following Table reflects the percentages that may be used to determine the qualifying portion of the account described in section 4.02. The Table is subject to prospective change, as necessary, in future revenue procedures.

REV. PROC. 90-10 TABLE	
Year	Percentage
1974	72
1975	70
1976	65
1977	62
1978	60
1979	55
1980	52
1981	50
subsequent years	50

.04 An election made under this revenue procedure with respect to intermodal cargo containers placed in service in a taxable year applies throughout the recapture period of section 47 of the Code in the case of the investment tax credit under section 38 and throughout the recovery period in the case of depreciation under section 168. The continuing eligibility of cargo containers subject to an election under section 4.01 for depreciation and for the investment credit must be determined each taxable year using the methods described in section 4.02. For purposes of investment tax credit recapture under section 47, all cargo containers in the account are considered placed in service on the first day of the taxable year in which they are actually placed in service, and the appropriate portion of the account is considered as no longer qualifying for the credit as of the first day of the taxable year in which the amount of qualifying basis determined under this elective method is reduced. The methods described in section 4.02 are the exclusive methods for purposes of determining recapture of the investment tax credit occurring due to failure to meet the requirements of section 48(a)(2)(B)(v) of the Code. A change in Table percentages between years is a change in use for purposes of depreciation under section 168. For purposes of determining the subsequent deduction, the change in use is considered as having occurred on the first day of the taxable year of the change in use.

Example. If a taxpayer placed cargo containers with an aggregate basis of $100x in service in 1978 and makes an election under section 4.01 of this revenue procedure for 1978, it will treat 60 percent of the aggregate basis of its cargo containers originally placed in service during that year as meeting the exception in section 48(a)(2)(B)(v) of the Code, or $60x, giving rise to an investment tax credit of $6x under section 46(b). Because the 1979 Table percentage is 55, only 55 percent of the aggregate basis in the 1978 account continued in a qualifying use in 1979 for purposes of section 48(a)(2)(B)(v). Therefore, the taxpayer must recapture $.50x in 1979 with respect to the 1978 cargo container, calculated as the difference between $6.00x and $5.50x ($100x multiplied by 55 percent), because this portion ($5x) did not continue to qualify as section 38 property during the entire recapture period. In addition, if 10 percent of the aggregate basis of the 1978 account were disposed of during 1979, the dispositions must be taken into account before the Table percentage is applied. Thus, the potentially qualified account would be reduced to $90x, and the amount that continues to qualify under section 48(a)(2)(B)(v) is $49.5x ($90x multiplied by 55 percent). In that event the taxpayer must recapture $1.05x in 1979 with respect to the 1978 cargo containers, calculated as the difference between $6.00x and $4.95x, because this portion ($10.5x) did not continue to qualify as section 38 property during the entire recapture period. The 1978 account is subject to similar recapture computations in subsequent years throughout the remaining recapture period taking into account the applicable percentages of section 46(c)(2) in conjunction with section 47(a)(1). For example, only 2/3 of the 1978 account's credit remaining on January 1, 1981, could be subject to recapture. See also, section 47(a)(5) regarding the recapture percentages for recovery property.

.05 The election in section 4.01 applies only to the determination of whether cargo containers owned by a United States person meet the requirements of section 48(a)(2)(B)(v) of the Code. Therefore, other applicable restrictions and requirements under the Code are not affected. See for example, the tax-exempt leasing provisions of former section 168(j) and sections 48(a)(5) and 168(h).

.06 An election under section 4.01 constitutes an irrevocable choice of the method of determining the investment in intermodal cargo containers that qualifies for the exception in section 48(a)(2)(B)(v) of the Code, and it is intended in part to obviate

litigation or other adversarial proceedings concerning qualification under section 48(a)(2)(B)(v). Therefore, a taxpayer making an election under section 4.01 with respect to intermodal cargo containers placed in service in a taxable year gives up any right it may have had to determine the level of qualification under that exception in any other manner.

SEC. 5. TIME AND MANNER OF MAKING THE ELECTION

.01 For cargo containers placed in service in taxable years beginning on or after January 1, 1989, the election provided in section 4.01 of this revenue procedure shall be made on or before the due date (taking extensions into account) of the tax return for the taxable year for which the election is to be effective.

.02 For cargo containers placed in service in taxable years beginning before January 1, 1989, the election provided in section 4.01 shall be made by filing an amended return no later than the later of September 15, 1990, or the due date (taking extensions into account) of the return for the first taxable year beginning in 1989 with the Service Center where the original return was filed.

.03 If the election relates to cargo containers placed in service in a taxable year for which a claim for credit or refund is barred under section 6511 of the Code (a closed year), such election must be filed with an amended return for the earliest taxable year not barred by the above limitation (open year). The election must state that it relates to property placed in service in a specific closed year. The taxpayer agrees to take into account all items affecting the computation of the investment tax credit allowed in an open year that are attributable to the cargo containers covered by the election for a closed year, even though such items may relate to a taxable year for which no tax may be assessed. See Rev. Rul. 69-543, 1969-2 C.B. 1.

.04 The election shall be made by attaching a statement to the tax return (or an amended return) for the taxable year for which the election is made. In the case of a partnership, the election shall be made at the partnership level by a tax matters partner, if one is required, or by a general partner. For cargo containers placed in service in taxable years beginning before January 1, 1989, the election is effective for a partner only if the partner files a return that satisfies section 5.02 of this revenue procedure. In the case of a Subchapter S corporation, the election shall be made at the corporate level. For cargo containers placed in service in taxable years beginning before January 1, 1989, the election is effective for a shareholder only if the shareholder files a return that satisfies section 5.02.

.05 Except as otherwise provided in the return or on the instructions accompanying the return for the taxable year, the statement shall:

1) Contain the name, address, and taxpayer identification number of the electing taxpayer,
2) Indicate that the election is made under the provisions of Rev. Proc. 90-10,
3) Specify the taxable year for which the election is being made and the aggregate bases of intermodal cargo containers described in section 3.02 and placed in service in the taxable year, which will become the initial account balance referred to in section 4.02.

SEC. 6. EFFECTIVE DATE

This revenue procedure is effective on January 29, 1990. See section 5 of this revenue procedure for the time to make an election.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 148; 1.148-1T.)

Rev. Proc. 90-11

SECTION 1. PURPOSE

This revenue procedure provides issuers of state or local bonds described in section 103(a) of the Internal Revenue Code with guidance for filing (1) a request for an extension of time to pay a correction amount of arbitrage rebate, (2) an explanation of an innocent failure to meet a requirement for payment of arbitrage rebate, or (3) a request for a ruling regarding a failure (other than an innocent failure or one that is so treated) to meet a requirement for payment of arbitrage rebate.

SEC. 2. BACKGROUND

.01 Section 103 of the Code provides, in general, that interest on any state or local bond is tax-exempt. Interest on an arbitrage bond within the meaning of section 148, however, is not tax-exempt. Section 103(b)(2).

.02 Section 148(f) of the Code generally provides that a bond that is part of an issue shall be treated as an arbitrage bond unless the issuer of the bond rebates to the United States arbitrage profits on nonpurpose investments allocable to the issue. Innocent failure and certain other failures to meet this requirement, however, are disregarded if the issuer takes certain actions, including payment of the correction amount. Section 1.148-1T(c) of the temporary Income Tax Regulations.

.03 Section 148(f)(3) of the Code provides that the arbitrage rebate is paid in installments. The rebate installments are generally due 60 days after the last day of the fifth bond year and each succeeding fifth bond year. The final rebate is generally due 60 days after the last bond that is part of the issue is discharged. In no case, however, is any rebate installment or final rebate due until January 16, 1990. Section 1.148-1T(b)(3) of the temporary regulations.

.04 Section 1.148-1T(b)(3)(v) of the temporary regulations provides that a rebate installment, final rebate, or correction amount is paid when filed with the Internal Revenue Service Center, Philadelphia, Pennsylvania 19255. The payment must be accompanied by Form 8038-T.

.05 Section 1.148-1T(c)(1)(i) of the temporary regulations provides that an innocent failure to meet a rebate requirement may be corrected by payment of the correction amount. If the correction amount is $50,000 or more, it must be paid no more than 60 days after the later of the date the failure first occurred or the date it was discovered. If the correction amount is less than $50,000, it must be paid no more than 180 days after the later of those two dates. The Commissioner may extend these times if the correction amount is less than $50,000 or if the issuer files a request

for extension before the expiration of such times. See section 3 of this revenue procedure for the procedures to request an extension of time.

.06 Section 1.148-1T(c)(2) of the temporary regulations provides the rules for computing the correction amount. The correction amount may be described generally as the sum of (1) the amount not paid when required, and (2) the amount that would have been earned if the preceding amount had been invested for the period of delay at the rate of interest for a United States Treasury obligation—Time Deposit State and Local Government Series with a term equal to such period. In the case of a rebate installment, however, these earnings are generally computed at a rate no less than the yield on the issue of bonds for which the rebate is payable.

.07 Section 1.148-1T(c)(1)(ii)(A) of the temporary regulations provides that the factors to be taken into account in determining whether a failure is innocent include the size of the correction amount, the size of the issue, the sophistication of the issuer (or ultimate obligor), the steps taken to comply with the requirements, the nature of the failure, and the length of the delay.

.08 Section 1.148-1T(c)(1)(ii)(B) of the temporary regulations provides that, if the correction amount is $50,000 or more, a failure cannot be treated as innocent unless the correction amount is accompanied by a brief explanation of the failure and the basis for concluding that the failure is innocent. An issuer need not explain an innocent failure requiring payment of a correction amount of less than $50,000. See section 4 of this revenue procedure for the procedures for filing an explanation of an innocent failure.

.09 Under section 1.148-1T(c)(1)-(ii)(C) of the temporary regulations, a failure is treated as innocent if:

(1) The correction amount is paid no later than the date specified in section 2.05 of this revenue procedure;

(2) In the case of a correction amount that is $50,000 or more, the brief explanation described in section 2.08 of this revenue procedure is reasonably accurate; and

(3) The Commissioner does not notify the issuer within 90 days after receipt of the correction amount that section 1.148-1T(c)(1)(ii)(C) does not apply.

.10 If the Service determines that section 1.148-1T(c)(1)(ii)(C) of the temporary regulations does not apply, the Service generally will proceed to determine whether the failure is otherwise treated as an innocent failure and will inform the issuers of both determinations within 90 days of the receipt of the correction amount.

.11 If the Service determines that section 1.148-1T(c)(1)(ii)(C) of the temporary regulations does apply, the Service will nevertheless inform the issuer that the failure is innocent, but only if the correction amount exceeds $50,000. The issuer will be so informed within 90 days of the receipt of the correction amount.

.12 Even if the failure to meet a rebate requirement is not innocent or not so treated, the failure may be disregarded under section 1.148-1T-(c)(3) of the temporary regulations if:

(1) The Commissioner determines that the failure is not due to willful neglect; and

(2) The issuer pays to the United States no later than the date specified by the Commissioner in such determination—

(a) The correction amount; and

(b) A penalty equal to the sum of—

(i) 50 percent of the amount of the rebate not paid when required (100 percent if any bond that is part of the issue is a private activity bond other than a qualified 501(c)(3) bond); and

(ii) An amount computed under the rules of sections 6621(a)(2) and 6622(a) of the Code with respect to the rebate not paid when required computed from the date the rebate was required to be paid to the payment date.

.13 Pursuant to section 1.148-1T-(c)(3) of the temporary regulations, the Commissioner may waive all or any portion of the penalty described in section 2.12 of this revenue procedure. See section 5 of this revenue procedure for the procedures to request a waiver of the penalty.

SEC. 3. PROCEDURES FOR REQUESTING EXTENSIONS OF TIME

.01 *Scope.* This section applies to issuers that need extensions of the time limits described in section 2.05 of this revenue procedure.

.02 *Procedures.* Issuers of state or local bonds that are requesting an extension of time as described in section 2.05 of this revenue procedure must:

(1) Prepare a request with the typed or printed heading "This Request For Extension Is Submitted Under Section 3 of Rev. Proc. 90-11";

(2) Set forth in the request—

(a) the name of the issuer,

(b) the name of the issue with respect to which the extension is requested,

(c) the CUSIP number for the bond with the latest maturity for which there is a CUSIP number,

(d) the date on which the rebate installment or final rebate is or was due, the date the failure first occurred, the date it was discovered, and the date to which the extension is requested (that is, the date the correction amount will be paid), and

(e) a brief explanation of the reasons why the rebate requirement was not timely met and a statement whether the bond issue in question is under examination by the Service;

(3) Include in the request a copy of the Form 8038, 8038-G, or 8038-GC filed with respect to the issue (if such form was required to be filed), but not a copy of any of the bond documents;

(4) Include in the request the following declaration signed by an authorized official of the requesting issuer or obligor with personal knowledge of the facts: "Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented are true, correct, and complete."; and

(5) Mail the request to the Internal Revenue Service Center, Statistics of Income Unit, P:DA:Unit F-SOI, Stop #335, Philadelphia, Pennsylvania 19255.

.03 *Request By Obligor.* An obligor on a purpose investment may

make the request described in this section if the issuer has delegated to the obligor the authority and responsibility for compliance with section 148(f) of the Code.

.04 *Fee.* There is no fee for a request made pursuant to this section.

SEC. 4. PROCEDURES FOR FILING AN EXPLANATION OF AN INNOCENT FAILURE

.01 *Scope.* This section applies to issuers that must file a statement of explanation described in section 2.08 of this revenue procedure.

.02 *Procedures.* When paying the correction amount, issuers of state or local bonds must:

(1) Attach a statement to the Form 8038-T that—

(a) explains the failure to meet the rebate requirement and the basis for concluding that the failure is innocent,

(b) discusses the factors set forth in section 2.07 of this revenue procedure and any other factors the issuer believes are relevant,

(c) includes any letters from the Philadelphia Service Center regarding extensions of time to file described in section 2.05, and

(d) specifies whether the bond issue in question is under examination by the Service (Copies of the bond documents should not be submitted with the statement.);

(2) Include in the explanation the following declaration signed by an authorized official of the requesting issuer or obligor with personal knowledge of the facts: "Under penalties of perjury, I declare that I have examined this explanation, including accompanying documents, and to the best of my knowledge and belief, the facts presented are true, correct, and complete."; and

(3) Mail the correction amount, Form 8038-T, and explanation to the Internal Revenue Service Center, Statistics of Income Unit, P:DA:Unit F-SOI, Stop #335, Philadelphia, Pennsylvania 19255.

.03 *Explanation By Obligor.* An obligor on a purpose investment may file the explanation described in this section if the issuer has delegated to the obligor the authority and responsibility for compliance with section 148(f) of the Code.

.04 *Fee.* There is no fee for filing an explanation of a failure to meet a rebate requirement pursuant to this section.

SEC. 5. PROCEDURES FOR REQUESTING A WAIVER OF PENALTY FROM THE NATIONAL OFFICE

.01 *Scope.* This section applies if an issuer of state or local bonds (or obligor on a purpose investment) has been informed by the Philadelphia Service Center that a failure to meet a rebate requirement is not innocent. The issuer (and, if desired, the obligor on the purpose investment) may then request a ruling from the National Office of the Internal Revenue Service—

(1) Holding that the failure to meet a rebate requirement was not due to willful neglect, and

(2) Waiving all or a portion of the penalty described in section 2.12 of this revenue procedure.

.02 *Procedures.* The request for a ruling must comply with the requirements of Rev. Proc. 90-1, page 356, this Bulletin, and Rev. Proc. 88-33, 1988-1 C.B. 835 (or their successors). The materials accompanying the request for ruling must include the letter from the Philadelphia Service Center concluding that the issuer's failure to meet a rebate requirement is not innocent.

SEC. 6. EFFECTIVE DATES

This revenue procedure is effective with respect to any request relating to rebate installments, or final rebates, that are due on or after January 16, 1990.

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, Section 170; 1.170A-1.)

Rev. Proc. 90-12[1]

SECTION 1. PURPOSE

These guidelines are intended to provide charitable organizations with help in advising their patrons of the deductible amount of contributions under section 170 of the Code when the contributors are receiving something in return for their contributions. These guidelines will also be used by agents in determining whether charities have provided accurate information about deductibility to their contributors.

SEC. 2. BACKGROUND

.01 Recently, the Congress expressed concern that charities do not accurately inform their patrons of the extent to which contributions are deductible. In expressing its concern, the Congress stated that it "anticipates that the Internal Revenue Service will monitor the extent to which taxpayers are being furnished accurate and sufficient information by charitable organizations as to the nondeductibility of payments to such organizations where benefits or privileges are received in return, so that taxpayers can correctly compute their Federal income tax liability." H.R. Rep. No. 100-391, 100th Cong., 1st Sess. 1608 (1987).

.02 In August 1988, the Service sent Publication 1391, Deductibility of Payments Made to Charities Conducting Fund-Raising Events, to over 400,000 charities. Publication 1391 contains a message from the Commissioner of the Internal Revenue Service asking charities for help in informing contributors more accurately about the deductibility of contributions made in connection with fund-raising events and programs.

.03 Publication 1391 also contains a copy of Rev. Rul. 67-246, 1967-2 C.B. 104, which discusses the rules that apply in determining the amount of a charitable contribution under section 170 of the Code when something of value is received in return for the contribution. Rev. Rul. 67-246 also sets forth a simple procedure that charities can use to provide "accurate and sufficient" information to their contributors.

.04 Rev. Rul. 67-246 asks charities to determine the fair market value of the benefits offered for contributions in advance of a solicitation and to state in the solicitation and in tickets, receipts, or other documents issued in connection with a contribution how much is deductible under section 170 of the Code and how much is not. If

[1]Also released as News Release IR-90-20, dated February 6, 1990.

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charities are unable to make an exact determination of the fair market value of the benefits, Rev. Rul. 67-246 indicates that they should use a reasonable estimate of fair market value.

.05 Many charities have suggested that this determination is difficult or burdensome particularly in the case of small items or other benefits that are of token value in relation to the amount contributed. The Service has determined that a benefit may be so inconsequential or insubstantial that the full amount of a contribution is deductible under section 170 of the Code. Under the following guidelines, charities offering certain small items or other benefits of token value may treat the benefits as having insubstantial value so that they may advise contributors that contributions are fully deductible under section 170.

SEC. 3. GUIDELINES

.01 Benefits received in connection with a payment to a charity will be considered to have insubstantial fair market value for purposes of advising patrons if the requirements of paragraphs 1 and 2 are met:

1. The payment occurs in the context of a fund-raising campaign in which the charity informs patrons how much of their payment is a deductible contribution, and either

2. (a) The fair market value of all of the benefits received in connection with the payment, is not more than 2 percent of the payment, or $50, whichever is less, or

(b) The payment is $25 (adjusted for inflation as described below) or more and the only benefits received in connection with the payment are token items (bookmarks, calendars, key chains, mugs, posters, tee shirts, etc.) bearing the organization's name or logo. The cost (as opposed to fair market value) of all of the benefits received by a donor must, in the aggregate, be within the limits established for "low cost articles" under section 513(h)(2) of the Code. (Generally, under section 170, the deductible amount of a contribution is determined by taking into account the fair market value, not the cost to the charity, of any benefits received in return. For administrative reasons, however, in the limited circumstances of this subparagraph, the cost to the charity may be used in determining whether the benefits are insubstantial.)

.02 For purposes of paragraph 1 of section 3.01, above, a qualifying fund-raising campaign is one designed to raise tax-deductible contributions, in which the charity determines the fair market value of the benefits offered in return for contributions (using a reasonable estimate if an exact determination is not possible), and states in its solicitations (whether written, broadcast, telephoned, or in person)—as well as in tickets, receipts, or other documents issued in connection with contributions—how much is deductible under section 170 of the Code and how much is not. If a charity is providing only insubstantial benefits in return for a payment, fund-raising materials should include a statement to the effect that: "Under Internal Revenue Service guidelines the estimated value of [the benefits received] is not substantial; therefore, the full amount of your payment is a deductible contribution."

.03 There may be situations in which it is impractical to state in every solicitation how much of a payment is deductible. For example, where a nonprofit broadcasting organization offers a number of premiums in an on-air fund-raising announcement, it may be unduly cumbersome to include information on the fair market value of each premium. If a charity believes that stating how much is deductible in every statement is impractical, it may seek a ruling from the Service concerning an alternative procedure. The Service will rule on whether the alternative procedure meets the Congressionally mandated goal of providing accurate and sufficient information to contributors. See Rev. Proc. 90-4, page 410, this Bulletin.

.04 For purposes of paragraph 2 of section 3.01, above, newsletters or program guides (other than commercial quality publications) will be treated as if they do not have a measurable fair market value or cost if their primary purpose is to inform members about the activities of an organization and if they are not available to nonmembers by paid subscription or through newsstand sales. Whether a publication is considered a commercial quality publication depends upon all of the facts and circumstances. Generally, publications that contain articles written for compensation and that accept advertising will be treated as commercial quality publications having measurable fair market value or cost. Professional journals (whether or not articles are written for compensation and advertising is accepted) will normally be treated as commercial quality publications. For purposes of subparagraph (b) of paragraph 2, the cost of a commercial quality publication include the costs of production and distribution and must be computed without regard to income from advertising or newsstand or subscription sales.

.05 In applying paragraph 2, the total amount of a pledge payable in installments will be considered to be the amount of the payment. Also, benefits provided by charities in the form of cash or its equivalent will never be considered insubstantial.

.06 For purposes subparagraph (b) of paragraph 2, an item is a "low cost article" under section 513(h)(2) of the Code if its cost does not exceed $5, increased for years after 1987 by a cost-of-living adjustment under section 1(f)(3). The $25 payment required in subparagraph (b) of paragraph 2 must also be increased, in the same manner. For calendar year 1990, the cost of a "low cost article" under section 513(h)(2) cannot exceed $5.45. The adjusted required payment is $27.26. See Rev. Proc. 90-7, page 432, this Bulletin.

.07 For purposes of subparagraph (b) of paragraph 2, if items offered to contributors are donated to the charity or if services are donated in connection with the production of an item, the cost "to the organization" for purposes of section 513(h)(2) of the Code will be a reasonable estimate of the amount the organization would have to pay for the items or services in question.

.08 These guidelines describe a safe harbor; depending on the facts in each case, benefits received in connection with contributions may be "insubstantial" even if they do not meet these guidelines.

SEC. 4. EXAMPLES

The following examples illustrate the application of the guidelines. In each example, it is assumed that the

charity is engaged in a fund-raising campaign which informs patrons how much of their payment is tax deductible as required by paragraph 1 of section 3.01:

Example 1. A zoo gives its patrons lapel pins reading "Friends of the Small City Zoo" in return for payments of $15. The fair market value of the lapel pin is $.25. Since the fair market value of the pin is less than 2 percent of the payment (and the fair market value of the pin is less than $50), the zoo may advise its patrons that the full amount of the payment is a deductible contribution.

Example 2. Assume the same facts as *Example 1.*, except that the zoo also sends patrons a newsletter the primary purpose of which is to inform members about the activities of the zoo. The newsletter is not available to nonmembers by paid subscription or through newsstand sales. Moreover, it is not a "commercial quality publication" as described in section 3.04, above. Since the newsletter has no fair market value for purposes of paragraph 2, and since the fair market value of the pin is less than 2 percent of the payment (and less than $50), the zoo may advise its patrons that the full amount of the payment is a deductible contribution.

Example 3. For a payment of $15, a museum sends its patrons a bulletin the primary purpose of which is to inform members about coming events at the museum. The bulletin is not available to nonmembers by paid subscription or through newsstand sales. The bulletin is written by a salaried staff member at the museum, but it accepts no advertising. It is printed on magazine quality paper and it is distributed on a quarterly basis. Under the facts and circumstances, the bulletin is not a "commercial quality publication" as described in section 3.04, above. Since the bulletin has no fair market value for purposes of paragraph 2 the museum may advise its patrons that the full amount of the payment is a deductible contribution.

Example 4. In 1990, a nonprofit broadcast organization sends its patrons a listener's guide for one year in return for a contribution of $30. The cost of production and distribution of the listener's guide is $4 per year per patron and its fair market value is $6. The listener's guide is not available to nonmembers by paid subscription or through newsstand sales. It is written by a salaried staff member at the broadcast organization and it accepts advertising. The listener's guide, therefore, is a "commercial quality publication" as described in section 3.04, above. However, since the cost of the listener's guide is $4 and it is received in return for a contribution of $30, the broadcast organization may advise its patrons that the full amount of the payment is a deductible contribution.

Example 5. Assume the same facts as *Example 4*, except that the nonprofit broadcast organization also gives its patrons a coffee mug with the organization's logo. The cost of a mug to the organization is $3. Its fair market value is $5. Since the listener's guide costs $4 and the coffee mug costs $3, their aggregate cost exceeds the 1990 limit of section 513(h)(2) of $5.45. The organization should inform its patrons that $19 of their contribution is deductible and $11 is not. The result would be the same even if these benefits were received separately in return for two separate contributions of $30 each. Under section 513(h)(2), the cost of all the low cost items received in one year is aggregated in determining whether the limit is exceeded.

SEC. 5. EFFECT ON OTHER DOCUMENTS

Rev. Rul. 67-246, 1967-2 C.B. 104 is amplified.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 90-13

SECTION 1. BACKGROUND AND PURPOSE

.01 Rev. Proc. 90-1, page 356, this Bulletin, provides procedures for issuing ruling letters involving substantive areas under the jurisdiction of the Associate Chief Counsel (Technical). Section 3.10 of Rev. Proc. 90-1 requires that ruling requests submitted on or after February 5, 1990, must contain a statement explaining why the requested ruling is not adequately addressed by published authority. Section 18.02 of the Rev. Proc. 90-1 provides that for ruling requests submitted on or after Febraury 5, 1990, the Internal Revenue Service will not rule, except in extraordinary circumstances, on issues that are clearly and adequately addressed by published authority.

.02 In Announcement 89-104, 1989-35 I.R.B. 19, and Announcement 89-105, 1989-35 I.R.B. 20, the Service invited public comment regarding possible modifications to the "comfort ruling" policy under which the Office of Associate Chief Counsel (Technical) will discontinue, except in extraordinary circumstances, the issuance of letter rulings with respect to issues that are clearly and adequately addressed by published authority.

.03 Announcement 90-21, 1990-6 I.R.B. 28, states that in order for the Office of Associate Chief Counsel (Technical) to have sufficient time to evaluate comments received concerning Announcements 89-104 and 89-105, the February 5, 1990, effective date for implementation of the "comfort ruling" policy set forth in section 3.01 and section 18.02 of Rev. Proc. 90-1, will be extended.

SEC. 2. PROCEDURE

Sections 3.10 and 18.02 of Rev. Proc. 90-1 are modified by deleting "February 5, 1990" and inserting in place thereof "May 7, 1990" in each section.

SEC. 3. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 90-1 is modified.

SEC. 4. EFFECTIVE DATE

This revenue procedure applies to all ruling requests postmarked or, if not mailed, received on or after February 5, 1990.

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26 CFR 601.701: Publicity of information. (Also Part I, Section 904; 1.904-4(d).)

Rev. Proc. 90-14

SECTION 1. PURPOSE

This revenue procedure provides safe harbors for complying with the

loss reserve reporting requirement of Section 7404(c) of the Revenue Reconciliation Act of 1989 (the "1989 Act").

SEC. 2. BACKGROUND

Section 904(d)(1)(B) of the Code (as amended by section 1201(a) of the 1986 Act) provides that foreign taxes paid with respect to "high withholding tax interest" are subject to a separate foreign tax credit limitation. Section 1201(e)(2) of the 1986 Act provides transitional relief from the application of that rule to interest received or accrued by a taxpayer on a "qualified loan" to any of the 33 countries listed therein (the "Listed Countries") or to a resident of any such Listed Country for use in such country. Section 7404(a) of the 1989 Act eliminates the transitional relief effective for taxable years beginning after December 31, 1989.

Pursuant to section 7404(c), however, transitional relief will continue to apply to a taxpayer if, on any financial statement filed by the taxpayer for regulatory purposes with respect to any quarter ending during the period beginning on March 31, 1989, and ending on December 31, 1989 (a "qualifying quarter"), the taxpayer showed loss reserves against its "qualified loans" equal to at least 25 percent of the amount of such loans. For purposes of section 7404(c), the term "qualified loan" has the meaning given such term by section 1201(e)(2)(H) of the 1986 Act (as in effect before its repeal by section 7404(a) of the 1989 Act).

SEC. 3. SCOPE AND OBJECTIVE

A taxpayer who complies with one of the safe harbors in section 4 or 5 will be considered to have satisfied the loss reserve reporting requirement of section 7404(c) of the 1989 Act. The safe harbors are to be applied by treating all members of a parent-subsidiary controlled group (as defined in section 1563(a)(1) of the Code and taking into account the exclusions provided in section 1563(b)(2) of the Code) as one taxpayer. The failure of a taxpayer to comply with one of the safe harbors will not necessarily subject the taxpayer to the application of section 7404(a) of the 1989 Act.

SEC. 4. CALL REPORT SAFE HARBOR

.01 In general. A taxpayer that is required to file a quarterly Consolidated Reports of Condition and Income on Form FFIEC 031, 032, 033 or 034 (a "Call Report") with an appropriate Federal Reserve District Bank, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC) or an appropriate state bank regulatory agency will be considered to have complied with the Call Report Safe Harbor if the taxpayer's call report reserve ratio for any qualifying quarter is at least 25 percent. A taxpayer's call report reserve ratio is determined from information included in a Call Report filed for a qualifying quarter. The Call Report must contain (in the space designated for inclusion of an optional narrative statement) the following information:

(a) the aggregate amount of the taxpayer's qualified loans outstanding as of the last day of such qualifying quarter, and

(b) the aggregate amount of loss reserves considered by the taxpayer to be attributable to such qualified loans as of the last day of such qualifying quarter.

The call report reserve ratio is the ratio of the aggregate amount of loss reserves described in clause (b) to the aggregate amount of qualified loans described in clause (a).

.02 Identification of qualified loans. For purposes of this Call Report Safe Harbor, a taxpayer, regardless of whether the taxpayer is required to file a Country Exposure Report (Form FFIEC 009), shall determine the aggregate amount of its qualified loans outstanding as of the last day of such qualifying quarter by computing the sum of the amounts required to be specified in Column 4 of a Country Exposure Report with respect to each of the Listed Countries.

.03 Application of call report safe harbor to a domestic parent-subsidiary controlled group.

1 In general. In the case of a domestic parent corporation that satisfies the stock ownership requirements of section 1563(a)(1) of the Code with respect to one or more domestic subsidiaries (herein referred to as "domestic controlled subsidiaries"), the resulting parent-subsidiary controlled group is treated as a single taxpayer in determining whether the 25 percent loss reserve ratio requirement is satisfied.

2 Call Report filed by controlled group member. A domestic parent corporation described in the preceding paragraph and each of its domestic controlled subsidiaries will be considered to have complied with the Call Report Safe Harbor if any member of the controlled group has specified in its Call Report filed for a qualifying quarter (in the space designated for inclusion of an optional narrative statement), and has computed its call report reserve ratio for such quarter on the basis of, the following:

(a) the sum of (i) the aggregate amount of qualified loans of the domestic parent corporation and (ii) the aggregate amount of qualified loans of all domestic controlled subsidiaries of the domestic parent corporation, in each case that are outstanding as of the last day of such qualifying quarter, and

(b) the sum of (i) the aggregate amount of loss reserves considered by the domestic parent corporation to be attributable to its portfolio of qualified loans and (ii) the aggregate amount of the loss reserves considered by each domestic controlled subsidiary to be attributable to its portfolio of qualified loans, in each case as of the last day of the qualifying quarter.

.04 Application of call report safe harbor to a domestic subsidiary of a foreign parent.

1 In general. In the case of a foreign parent corporation that is subject to tax under section 882 of the Code and that satisfies the stock ownership requirements of section 1563(a)(1) of the Code with respect to one or more domestic subsidiaries, the resulting controlled group is treated as a single taxpayer in determining whether the 25 percent loss reserve ratio requirement is satisfied.

2 Identification of qualified loans. Each domestic controlled subsidiary of a foreign parent corporation described in the preceding paragraph, and any United States branch of such a foreign parent corporation, will be considered to have complied with the

Call Report Safe Harbor if at least one domestic controlled subsidiary of such foreign parent corporation has specified in its Call Report filed for a qualifying quarter (in the space designated for inclusion of an optional narrative statement), and has computed its call report reserve ratio on the basis of, the sum of:

(a) the aggregate amount of qualified loans of such domestic controlled subsidiary that are outstanding as of the last day of such qualifying quarter, and

(b) the aggregate amount of qualified loans of all other domestic controlled subsidiaries and all United States branches of the foreign parent corporation that are outstanding as of the last day of such qualifying quarter.

The total amount of qualified loans outstanding with respect to any domestic controlled subsidiary or United States branch of a foreign parent corporation shall be determined, regardless of whether the subsidiary or branch is required to file a Country Exposure Report, by computing for such subsidiary or branch the sum of the amounts required to be specified in Column 4 of a Country Exposure Report with respect to each of the Listed Countries.

3 Identification of loss reserves. In addition, the Call Report filed by such domestic controlled subsidiary with respect to a qualifying quarter must have specified (and the subsidiary must have computed its call report reserve ratio on the basis of) the sum of:

(a) the aggregate amount of loss reserves considered by the domestic controlled subsidiary to be attributable to its qualified loans as of the last day of such qualifying quarter, and

(b) the aggregate amount of the loss reserves considered by each other domestic controlled subsidiary and by each United States branch of the foreign parent corporation (or on behalf of any such branch by the home office of such foreign parent corporation) to be attributable to its respective qualified loans as of the last day of such qualifying quarter.

.05 United States branch of a foreign corporation. In the event that a United States branch of a foreign corporation is not described in subsection .04, such branch may comply with the Call Report Safe Harbor by applying principles similar to those of subsection .04.

SEC. 5. SEC RECOMPUTED RESERVE RATIO SAFE HARBOR

.01 In general. A taxpayer that is required to file quarterly and annual reports with the Securities Exchange Commission (SEC) on Forms 10-Q and 10-K, respectively, during the 1989 calendar year will be considered to have complied with the SEC Recomputed Reserve Ratio Safe Harbor if such taxpayer satisfies the following requirements with respect to a qualifying quarter.

(a) The taxpayer must identify on its Form 10-Q filed with the SEC for such qualifying quarter (or, in the event that such quarter is the fourth quarter of the taxpayer's fiscal year, on the Form 10-K filed by the taxpayer with respect to such quarter and such fiscal year) a group of countries (referred to in this revenue procedure as a "restructuring group"):

(i) to which, or to borrowers in which, the taxpayer has outstanding claims as of the last day of such qualifying quarter, and

(ii) which are or have engaged in a plan of restructuring their external obligations or which are considered less developed countries.

A taxpayer need not have designated such a group for internal or reporting purposes as a "restructuring group," as long as such a group is clearly identified in such Form 10-Q or 10-K. A restructuring group identified by a taxpayer need not consist solely of Listed Countries, and it is not necessary that all Listed Countries to which (or to borrowers in which) the taxpayer has outstanding claims be included in such a group. Loans to Listed Countries, however, must comprise at least 60 percent of the total amount of outstanding loans to the countries included in such restructuring group.

Although it is not necessary that all countries included in a taxpayer's restructuring group be identified in such Form 10-Q or 10-K, either (i) a complete list of the countries included in such group must have been included in a Form 10-Q or 10-K filed with the SEC for any quarter or fiscal year ending within the one-year period immediately preceding the qualifying quarter or (ii) the taxpayer must attach to its federal income tax return for its 1989 taxable year a statement containing a complete list of such countries.

(b) The taxpayer has reported on such Form 10-Q or 10-K, at a minimum, its total amount of cross-border outstandings (other than short-term outstandings and trade credits) to (or to borrowers in) the countries included in such restructuring group. For this purpose, the terms "cross-border outstandings" and "short-term outstandings" shall have the meanings given such terms in Exchange Act Industry Guide 3 of the Securities Act and Exchange Act Industry Guides. For purposes of this subparagraph (b), it is not necessary that the total amount of cross-border outstandings reported by the taxpayer include cross-border outstandings that are guaranteed by a third party located in a country which is not included in the taxpayer's restructuring group (herein "guaranteed outstandings").

(c) The taxpayer has reported on such Form 10-Q or 10-K, at a minimum, the total amount of loss reserves that it considers to be attributable to its cross-border outstandings (other than short-term outstandings, trade credits and guaranteed outstandings) to (or to borrowers in) the countries included in its restructuring group.

(d) The recomputed reserve ratio with respect to such qualifying quarter is at least 25 percent, calculated in accordance with section 6 of this revenue procedure.

SEC. 6. RECOMPUTED RESERVE RATIO

.01 A taxpayer must compute the recomputed reserve ratio with respect to any qualifying quarter in accordance with the following steps.

(a) The taxpayer determines the aggregate amount of loans outstanding as of the last day of such qualifying quarter to (or to borrowers in) any country that is a Listed Country included in the taxpayer's restructuring group.

(b) The taxpayer determines the aggregate amount of loans outstanding as of the last day of such qualifying

quarter to (or to borrowers in) any Listed Country that is not included in the taxpayer's restructuring group.

(c) The taxpayer adds the amounts determined under subparagraphs (a) and (b) above to determine the recomputed loans outstanding to (or to borrowers in) the Listed Countries as of the last day of such qualifying quarter.

(d) The taxpayer computes the aggregate amount of loss reserves deemed allocated by the taxpayer to loans reported as outstanding to (or to borrowers in) any Listed Country that is included in the taxpayer's restructuring group. This amount is to be determined by multiplying (i) the total amount of loss reserves that it has reported on such 10-Q or 10-K as attributable to loans outstanding to (or to borrowers in) countries included in such restructuring group (sec. 5.01(c) above) by (ii) the percentage of loans reported as outstanding to the restructuring group that are attributable to Listed Countries. For purposes of determining the percent age of loans reported as outstanding to its restructuring group that are attributable to Listed Countries, the taxpayer shall compute the sum of the amounts required to be specified in the columns of the Country Exposure Report that correspond to the categories of loans included in such reported total with respect to each Listed Country included in the restructuring group.

(e) The taxpayer computes the aggregate amount of loss reserves deemed allocated by the taxpayer to (i) loans outstanding to (or to borrowers in) any Listed Country that is not included in the taxpayer's restructuring group and (ii) loans that are outstanding to (or to borrowers in) any Listed Country included in the taxpayer's restructuring group but that are not reported by the taxpayer in accordance with section 5.01(b) above. This amount is to be determined by multiplying (1) the total amount of loss reserves that it has reported on such 10-Q or 10-K as attributable to loans outstanding to (or to borrowers in) countries (other than the United States), excluding the amount of loss reserves determined pursuant to subparagraph (d), by (2) the ratio of (A) the sum of the total amount of loans outstanding as of the last day of such qualifying quarter to Listed Countries not included within the taxpayer's restructuring group and the total amount of loans that are outstanding to Listed Countries included in the taxpayer's restructuring group but that are not reported by the taxpayer in accordance with section 5.01(b) above to (B) the total amount of loans outstanding to countries other than the United States, excluding loans that are reported by the taxpayer in accordance with section 5.01(b) above.

(f) The taxpayer adds the amounts determined under subparagraphs (d) and (e) to determine the recomputed loss reserves.

(g) The taxpayer computes the recomputed reserve ratio. That amount is the ratio of the recomputed loss reserves (subparagraph (f)) to the recomputed loans outstanding to (or to borrowers in) the Listed Countries (subparagraph (c)).

The taxpayer must attach to its federal income tax return for its 1989 taxable year a statement containing the above computations.

.02 Identification of Loans. For purposes of computing its recomputed reserve ratio, the taxpayer shall determine the aggregate amount of loans outstanding as of the last day of a qualifying quarter to (or to borrowers in) any country by computing with respect to such country the sum of the amounts required to be specified in Column 4 of a Country Exposure Report, regardless of whether the taxpayer is required to file a Country Exposure Report.

SEC. 7. EFFECTIVE DATE

This revenue procedure applies to Call Reports and Forms 10-Q and 10-K, as described above, filed by a taxpayer for regulatory purposes with respect to any quarter ending during the period beginning on March 31, 1989, and ending on December 31, 1989. This revenue procedure will also apply to an amended Call Report or Form 10-Q or 10-K for any qualifying quarter.

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, Sections 62, 162, 274; 1.62-2T, 1.162-17, 1.274-5T.)

Rev. Proc. 90-15

SECTION 1. PURPOSE

This revenue procedure amplifies Rev. Proc. 89-67, 1989-2 C.B. 795, by providing an optional method for employees and self-employed individuals to use in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home. Use of this method is not mandatory, and a taxpayer may deduct actual allowable expenses if adequate records or other sufficient evidence are maintained for proper substantiation.

SEC. 2. PROCEDURE

Rev. Proc. 89-67 is hereby amplified by adding new subsections 4.03, 7.06, 7.07, 8.03, and 8.04, and modifying subsection 6.05, as follows:

SEC. 4. PER DIEM SUBSTANTIATION METHOD

. . . . .

.03 *Optional method for meals only deduction.* In lieu of using actual expenses, employees and self-employed individuals, in computing the amount allowable as a deduction for ordinary and necessary business meal and incidental expenses paid or incurred for travel away from home, may use an amount computed at the Federal M&IE rate for the locality of travel for the period the employee or self-employed individual is away from home. Such amount will be deemed substantiated for purposes of paragraphs (b)(2) (travel away from home) and (c) of section 1.274-5T of the temporary regulations, provided the employee or self-employed individual substantiates the elements of time, place, and business purpose of the travel expenses in accordance with those regulations.

SEC. 6. LIMITATIONS

. . . . .

.05 *Application of the 80-percent limitation on meal expenses.* When a per diem allowance is paid only for meal and incidental expenses or when an amount for meal and incidental

expenses is computed pursuant to section 4.03 above, an amount equal to the lesser of the per diem allowance or the Federal M&IE rate for the locality of travel for the period away from home is treated as an expense for food and beverages. When a per diem allowance is paid for lodging, meal, and incidental expenses, the payor must treat an amount equal to the Federal M&IE rate for the locality of travel for the period the employee is away from home as an expense for food and beverages. For purposes of the preceding sentence, when a per diem allowance for lodging, meal and incidental expenses for a full day of travel is paid at a rate that is less than the Federal per diem rate for the locality of travel, the payor may treat an amount equal to 40 percent of such per diem allowance for a full day of travel as the Federal M&IE rate for the locality of travel.

SEC. 7. APPLICATION

. . . . .

.06 An employee may deduct an amount computed pursuant to section 4.03 above only as an itemized deduction. This itemized deduction is subject to the 80-percent limitation on meal and entertainment expenses provided in section 274(n) of the Code and the 2-percent floor on miscellaneous itemized deductions provided in section 67.

.07 A self-employed individual may deduct an amount computed pursuant to section 4.03 above in determining adjusted gross income under section 62(a)(1) of the Code. This deduction is subject to the 80-percent limitation on meal and entertainment expenses provided in section 274(n) of the Code.

SEC. 8. EFFECT ON OTHER DOCUMENTS

. . . . .

.03 Rev. Proc. 83-71, 1983-2 C.B. 590, which sets forth an optional method that employees and self-employed individuals may use in computing the amount allowable as a deduction for business meal expenses paid or incurred for travel away from home, is hereby superseded for such expenses paid or incurred on or after January 1, 1989.

.04 Notice 87-23, 1987-1 C.B. 467, at 468, which in part provides for a reasonable allocation of a single amount paid to cover lodging, meal, and other expenses, is modified pursuant to section 6.05 above for per diem allowances paid to an employee on or after January 1, 1990, with respect to lodging, meal, and incidental expenses paid or incurred for travel while away from home on or after January 1, 1990.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Section 6662.)

Rev. Proc. 90-16

SECTION 1. PURPOSE

.01 This revenue procedure updates Rev. Proc. 89-11, 1989-1 C.B. 797, and identifies circumstances under which the disclosure on a taxpayer's return of an item or a position taken is adequate disclosure for the purpose of reducing the understatement of income tax under section 6662(d) of the Internal Revenue Code, as enacted by the Revenue Reconciliation Act of 1989 (the Act), Pub. L. No. 101-239, section 7721, 103 Stat. 2106 (1989), applicable to returns the due date of which (determined without regard to extensions) is after December 31, 1989. This revenue procedure applies only to disclosures of an item or position taken for purposes of reducing the understatement of income tax for purposes of the penalty for substantial understatement of income tax under section 6662(d) (and, to the extent indicated in section 1.02 below, former section 6661). This revenue procedure does not apply with respect to any other penalty provision.

.02 This revenue procedure applies under section 6662 of the Code to any taxpayer filing a return on 1989 tax forms for a taxable year beginning in 1989, the due date for which is after December 31, 1989 (determined without regard to extensions), and to any taxpayer filing on 1989 tax forms in 1990 for short taxable years beginning in 1990. This revenue procedure also applies under former section 6661 to any taxpayer filing a return on 1989 tax forms for a taxable year that began and ended in 1989, the due date for which was before January 1, 1990 (determined without regard to extensions).

SEC. 2. CHANGES FROM PREVIOUS YEAR

Although no substantive changes relating to forms or line items have been made from the previous year, the references to Code provisions in this revenue procedure have been revised to reflect the enactment of new section 6662 of the Code.

SEC. 3. BACKGROUND

.01 The Act consolidated the major penalties relating to the accuracy of a return, including the penalty under former section 6661 of the Code for substantial understatements of income tax, into new section 6662 and repealed the various sections of the Code that formerly imposed those penalties, including former section 6661, effective for returns the due date for which is after December 31, 1989 (determined without regard to extensions). For further information, see Notice 90-20, page 17, this Bulletin, published concurrently with this revenue procedure.

.02 If section 6662 of the Code applies to any portion of an underpayment of tax required to be shown on a return, an amount equal to 20 percent of the portion of the underpayment to which the section applies shall be added to the tax. Under section 6662(b)(2), section 6662 applies to the portion of any underpayment that is attributable to any substantial understatement of income tax.

.03 Section 6662(d)(1) of the Code provides that there is a substantial understatement of income tax if the amount of the understatement exceeds the greater of 10 percent of the amount required to be shown on the return or $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). Section 6662(d)(2) defines an understatement as the difference between the amount of tax required to be shown on the return for the taxable year and the amount of the tax that is actually shown on the return (reduced by any rebate within the meaning of section 6211(b)(2)).

.04 In the case of an item not

attributable to a tax shelter, section 6662(d)(2)(B)(ii) of the Code provides that the amount of the understatement is reduced by the portion of the understatement attributable to any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return.

.05 In general, this revenue procedure provides guidance in determining when disclosure is adequate for purposes of section 6662(d) of the Code. For purposes of this revenue procedure, the taxpayer must furnish all required information in accordance with the applicable forms and instructions, and the money amounts entered on these forms must be verifiable. Guidance under section 6661 for returns filed in 1983, 1984, 1985, 1986, 1987, 1988, and 1989 is provided in Rev. Proc. 83-21, 1983-1 C.B. 680, Rev. Proc. 84-19, 1984-1 C.B. 433, Rev. Proc. 85-19, 1985-1 C.B. 520, Rev. Proc. 86-22, 1986-1 C.B. 562, Rev. Proc. 87-48, 1987-2 C.B. 645, Rev. Proc. 88-37, 1988-2 C.B. 560, and Rev. Proc. 89-11, respectively.

SEC. 4. PROCEDURE

Additional disclosure of facts relevant to, or positions taken with respect to, issues involving any of the items set forth below is unnecessary for purposes of reducing any understatement of income tax under section 6662(d) of the Code (or section 6661 of prior law, to the extent indicated in section 1.02 of this revenue procedure) provided that the forms and attachments are completed in a clear manner and in accordance with their instructions. Pursuant to the forms and instructions, items must not be combined but must be separately stated on the appropriate line. The money amounts entered on the forms must be verifiable, and the information on the return must be disclosed in the manner described below. For purposes of this revenue procedure, a number is verifiable if, on audit, the taxpayer can demonstrate the origin of the number (even if that number is not ultimately accepted by the Internal Revenue Service) and the taxpayer can show good faith in entering that number on the applicable form.

(a) Form 1040, Schedule A, Itemized Deductions:

(1) Medical and Dental Expenses: Complete lines 1-4 supplying all required information. Line 1b must list each item and the amount paid.

(2) Taxes: Complete lines 5-8 supplying all required information. Line 7 must list each type of tax and the amount paid.

(3) Interest Expense: Complete lines 9-13 supplying all required information. This section of the procedure does not apply to (i) amounts disallowed under section 163(d) of the Code unless Form 4952, Investment Interest Expense Deduction, is completed, or (ii) any amounts disallowed under section 265 of the Code.

(4) Contributions: Complete lines 14-17 supplying all required information. Merely entering the name of an organization to which the taxpayer makes a donation and the amount of the donation on Schedule A, however, will not constitute adequate disclosure if the taxpayer receives a substantial benefit from the donation shown. If a contribution of property other than cash is made and the amount claimed as a deduction exceeds $500, a properly completed Form 8283, Noncash Charitable Contributions, must be attached to the return.

(5) Casualty and Theft Losses: Form 4684, Casualties and Thefts, must be completed and attached to the return. Each item or article for which a casualty or theft loss is claimed must be listed on Form 4684.

(6) Moving Expenses: Complete Form 3903, Moving Expenses, or Form 3903F, Foreign Moving Expenses, and attach to the return.

(b) Certain Trade or Business Expenses (which, for purposes of this revenue procedure, include the following six expenses as they relate to the rental of property):

(1) Casualty and Theft Losses: The procedure outlined in (a)(5) above must be followed.

(2) Legal Fees: The amount claimed must be stated.

(3) Specific Bad Debt Charge-off: The amount written off must be stated.

(4) Reasonableness of Officers' Compensation: Form 1120, Schedule E, must be completed when required by instructions. The time devoted to business must be expressed as a percentage as opposed to "part" or "as needed." This section 4(b)(4) does not apply to "golden parachute" compensation prohibited by section 280G of the Code.

(5) Repair as Opposed to Capital Expenditure: The amount of repairs claimed must be stated.

(6) Taxes (other than foreign taxes): The amount of taxes claimed must be stated.

(c) An item clearly identified on Form 1120, Schedule M-1, Reconciliation of Income Per Books With Income Per Return, is adequately disclosed only if:

(1) The amount of the deviation from the financial books and records is not the result of a computation that includes the netting of items; and

(2) The information provided reasonably may be expected to apprise the Service of the nature of the potential controversy concerning the tax treatment of the item.

(d) Other:

(1) Sale or Exchange of Your Main Home: Complete Form 2119, Sale of Your Home, and attach to the return.

(2) Employee Business Expenses: Complete Form 2106, Employee Business Expenses, and attach to the return.

(3) General Business Credit Carryforwards: Amounts shown on Line 10, Form 3800, General Business Credit.

(4) Fuels Credit: Amounts shown on Form 4136, Computation of Credit for Federal Tax on Fuels.

(5) Investment Credit: Complete Form 3468, Computation of Investment Credit, and attach to the return.

(e) Foreign Tax Items:

(1) International Boycott Transactions: Transactions disclosed on Form 5713, International Boycott Report.

(2) Intercompany Transactions: Transactions and amounts shown on Form 5471, Schedule G.

SEC. 5. EFFECTIVE DATE

This revenue procedure applies under section 6662 of the Code to any taxpayer filing a return on 1989 tax forms for a taxable year beginning in 1989, the due date for which is after December 31, 1989 (determined without regard to extensions), and to any

taxpayer filing on 1989 tax forms in 1990 for short taxable years beginning in 1990. This revenue procedure also applies under former section 6661 to any taxpayer filing a return on 1989 tax forms for a taxable year that began and ended in 1989, the due date for which was before January 1, 1990 (determined without regard to extensions).

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 90-17

SECTION 1. PURPOSE

This revenue procedure makes certain changes in the user fee program of the Internal Revenue Service that was established pursuant to section 10511 of the Revenue Act of 1987 (Title X of the Omnibus Budget Reconciliation Act of 1987), Public Law 100-203, enacted December 22, 1987. The program was previously set forth in Rev. Proc. 89-4, 1989-1 C.B. 767.

SEC. 2. CHANGES

.01 *Fee Increases.* Because section 10511 of the Revenue Act of 1987 ("Act") provides that user fees are to be determined after taking into account the average time for, and difficulty of, complying with requests in each category (and subcategory), user fees should bear a direct relationship to the cost of providing the ruling, etc. After studying the direct and indirect (overhead) costs of preparing, reviewing, and processing a ruling, it became evident that most of the user fees in the fee schedule set forth in Rev. Proc. 89-4 did not recover the cost of providing rulings, etc., or did not accurately reflect the time necessary to process the request or the complexity of the request. Consistent with section 10511 of the Act, most of the fees have been increased. However, reduced fees are provided for appropriate subcategories of cases.

The changes to the fee schedule were made only after considerable cost and other analyses and the benefit of public commentary to Announcement 89-104, 1989-35 I.R.B. 19. The announcement solicited comments concerning possible modifications to the "comfort ruling" policy, which is now described in Rev. Proc. 90-1, page 356, this Bulletin, and to other initiatives the Office of the Associate Chief Counsel (Technical) might undertake to improve the private letter ruling process. Public comments in response to Announcement 89-104 and Announcement 89-105, 1989-34 I.R.B. 20, which answers a number of commonly asked questions concerning Rev. Proc. 89-34, 1989-1 C.B. 917, including how the Associate Chief Counsel (Technical)'s "comfort ruling" policy described therein is to be administered, are now being evaluated and it is possible that the Service may decide to issue "comfort rulings." If it does, section 1(c) of the fee schedule states that consideration will be given to charging a higher user fee for them.

Most of the fee revisions are effective for receipts after March 31, 1990; however, the revised fees for Employee Plans Opinion, Notification, and Determination letter requests and Exempt Organizations Determination letter requests are effective for receipts after September 30, 1990. The fees set forth in this revenue procedure that are effective after September 30, 1990, will apply only if legislation is enacted to extend the user fee program beyond September 30, 1990. The new fee schedule is provided below in section 6.03 of this revenue procedure.

.02 *Incorporation of Modifications of Rev. Proc. 89-4.* Rev. Proc. 89-4 was modified by section 19.04 of Rev. Proc. 89-9, which prescribed the user fee applicable to advisory letters concerning a mass submitter's addition of optional provisions following the issuance of a favorable opinion letter, and by section 17 of Rev. Proc. 89-13, which prescribed the user fees applicable to sponsors of regional prototype plans, mass submitters of such plans, and adopters of such plans. Those modifications are contained in section 6.03 of this revenue procedure.

.03 *Addition of New Subcategories.* "Requests for rulings under Rev. Proc. 89-35" has been added as a subcategory in the Employee Plans Rulings category, with a user fee of $100. "Requests for determination letters on multiple employer plans" has been added as a subcategory in the fee schedule, under the Employee Plans Determination Letters category. "Group exemption letters" has been added as a subcategory under the Exempt Organization Determination Letters category.

SEC. 3. BACKGROUND

.01 Section 10511 of the Revenue Act of 1987 ("Act") provides that the Secretary of the Treasury or his delegate ("Secretary") shall establish a program requiring the payment of user fees for requests to the Service for rulings, opinion letters, determination letters, and similar requests. Section 10511 provides that such fees shall apply with respect to requests made on or after the 1st day of the second calendar month beginning after the date of enactment and before September 30, 1990. The fees charged under the program are to vary according to categories (or subcategories) established by the Secretary; they are to be determined after taking into account the average time for, and difficulty of, complying with requests in each category and subcategory; and they are to be payable in advance. The Secretary is to provide for such exemptions and reduced fees under the program as the Secretary determines to be appropriate, but the average fee applicable to each category must not be less than the amount specified in the statute.

.02 Rev. Proc. 88-8, 1988-1 C.B. 628, which established the user fee program mandated by Section 10511 of the Act, was modified by Rev. Proc. 88-13, 1988-1 C.B. 639, and Rev. Proc. 88-27, 1988-1 C.B. 804. Rev. Procs. 88-8, 88-13 and 88-27 were superseded by Rev. Proc. 89-4 with respect to requests for rulings, determination letters, etc. received on or after February 1, 1989.

SEC. 4. RELATED REVENUE PROCEDURES AND NOTICES

.01 Rev. Proc. 90-1, page 356, this Bulletin, provides, other than for international issues, procedures for issuing rulings and information letters and for entering into closing agreements on specific issues involving the interpretation or application of the federal tax laws under the jurisdiction of the Associate Chief Counsel (Technical). It also provides, other than for international issues, procedures for issuing determination letters on matters that relate to sections of the Code under the jurisdiction of the Associate Chief Counsel (Technical).

.02 Rev. Proc. 90-3, page 402, this Bulletin, updates Rev. Proc. 89-3, 1989-1 C.B. 761, as amplified and modified by subsequent revenue procedures, by providing a revised list of those areas of the Code under the jurisdiction of the Associate Chief Counsel (Technical) relating to issues in which the Service will not issue advance rulings or determination letters.

.03 Concerning international issues, Rev. Proc. 87-4, 1987-1 C.B. 529, as modified by Rev. Proc. 88-4, 1988-1 C.B. 586, provides procedures for obtaining rulings, closing agreements, and information letters on federal tax issues under the jurisdiction of the Associate Chief Counsel (International) and provides information concerning determination letters under the jurisdiction of the Assistant Commissioner (International) and the District Directors.

.04 Rev. Proc. 90-6, page 430, this Bulletin, sets forth a list of areas under the jurisdiction of the Associate Chief Counsel (International) relating to international issues in which the Service will not issue advance rulings or determination letters.

.05 Rev. Proc. 90-4, page 410, this Bulletin, sets forth the general procedures of the Service in issuing rulings, determination letters, opinion letters, notification letters, and information letters to taxpayers and in entering into closing agreements on specific issues as to the interpretation or application of the federal tax laws in the employee plans and exempt organizations areas.

.06 Rev. Proc. 78-37, 1978-2 C.B. 540, sets forth the procedure by which a plan administrator or plan sponsor may obtain approval of the Secretary of the Treasury for a change in funding method as provided by section 412(c)(5) of the Code and section 302(c)(5) of the Employee Retirement Income Security Act of 1974 (ERISA).

.07 Rev. Proc. 79-18, 1979-1 C.B. 525, outlines the procedure by which a plan administrator or plan sponsor may file notice with and obtain approval from the Secretary of the Treasury for a retroactive plan amendment described in section 412(c)(8) of the Code and section 302(c)(8) of ERISA.

.08 Rev. Proc. 79-61, 1979-2 C.B. 575, outlines the procedure by which a plan administrator or plan sponsor may request and obtain approval for an extension of an amortization period in accordance with section 412(e) of the Code and section 304(a) of ERISA.

.09 Rev. Proc. 79-62, 1979-2 C.B. 576, outlines the procedure by which a plan sponsor or administrator may request a determination that a plan amendment is reasonable and provides for only de minimis increases in plan liabilities in accordance with section 412(f)(2)(A) of the Code and section 304(b)(2)(A) of ERISA.

.10 Rev. Proc. 80-30, 1980-1 C.B. 685, sets forth the general procedures of the various offices of the Service pertaining to the issuance of determination letters on the qualification of pension, annuity, profit-sharing and stock bonus plans involving sections 401, 403(a), 409 and 4975(e)(7) of the Code, and the status for exemption of any related trusts or custodial accounts under section 501(a).

.11 Rev. Proc. 83-41, 1983-1 C.B. 775, as modified by Rev. Proc. 88-5, 1988-1 C.B. 587, and Rev. Proc. 88-29, 1988-1 C.B. 828, outlines the procedures of the Service with respect to applications for waivers of the minimum funding standard under either section 412(d) of the Code or section 303 of ERISA.

.12 Rev. Proc. 84-46, 1984-1 C.B. 541, provides procedures for applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code.

.13 Rev. Proc. 87-50, 1987-2 C.B. 647, updates and consolidates in one revenue procedure the procedures of the Service relating to the issuance of rulings and opinion letters with respect to the establishment of individual retirement accounts and annuities (IRAs) under section 408 of the Code, the entitlement to exemption of related trusts or custodial accounts under section 408(e), and the acceptability of the form of prototype simplified employee pension (SEP) agreements under sections 408(k) and 415.

.14 Rev. Proc. 89-9, 1989-1 C.B. 780, sets forth the procedures of the Service pertaining to the issuance of opinion letters relating to master or prototype pension, profit-sharing and annuity plans involving sections 401 and 403(a) of the Code, as amended by the Tax Reform Act of 1986 (TRA '86), the Omnibus Budget Reconciliation Act of 1986 (OBRA '86), the Omnibus Budget Reconciliation Act of 1987 (OBRA '87), and the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), and the status for exemption of related trusts or custodial accounts under section 501(a).

.15 Rev. Proc. 89-13, 1989-1 C.B. 801, sets forth the procedures of the Service for issuing notification letters relating to the qualification, as to form, of certain regional prototype defined contribution plans and defined benefit plans, and provides guidance with respect to the issuance of determination letters to employers adopting such plans as to whether the plans as adopted qualify under sections 401 and 403(a) of the Code and as to whether any related trusts or custodial accounts are exempt under section 501(a).

.16 Rev. Proc. 89-35, 1989-1 C.B. 917, sets forth a procedure by which a plan administrator or plan sponsor of a qualified defined benefit pension plan may under certain circumstances satisfy the requirement that a deduction under section 404 of the Code be disallowed by the Secretary of the Treasury, thereby fulfilling a condition under which a contribution may revert to the employer without adversely affecting the plan's qualified status.

SEC. 5. SCOPE

All requests for rulings, opinion letters, notifications letters, and determination letters submitted by or on behalf of taxpayers, sponsoring organizations or other entities must be accompanied by the appropriate user fee as determined from the fee schedule set forth in section 6.03 below. User fees apply to all requests for reconsideration of rulings, determination letters or opinion letters, but may be refunded in certain situations (see section 6.13(2) below). User fees do not apply to requests for information letters.

SEC. 6. PROCEDURE

.01 Definitions.

(1) The terms "adoption agreement," "advisory letter," "basic plan document," "determination letter,"

"information letter," "mass submitter," "master plan," "notification letter," "opinion letter," "prototype plan," "regional prototype plan," "ruling," "sponsor," and "sponsoring organization" as used in this revenue procedure have the same meaning as they have in the pertinent revenue procedure referred to in section 4 above.

(2) The term "group exemption letter" means a ruling or determination letter issued to a central organization recognizing on a group basis the exemption, under section 501(a) of the Code, of subordinate organizations on whose behalf the central organization has applied for recognition of exemption, as described in Internal Revenue Service Publication 557, *Tax-Exempt Status for Your Organization.*

.02 *Volume Submitter Plans.* The following definitions apply for purposes of determining the user fee for advisory letter requests for volume submitter specimen plans and determination letter requests upon an employer's adoption of a volume submitter specimen plan.

(a) A volume submitter plan is a profit-sharing plan, 401(k) plan, money purchase pension plan, target benefit plan, or defined benefit plan which meets certain criteria established by an individual key district office and which is submitted pursuant to procedures established by the key district office.

(b) A volume submitter specimen plan is a plan described in (a) above that is submitted to the key district office by a practitioner who certifies that no fewer than 30 employers within any two regions of the Service are expected to adopt a plan that is substantially identical to the specimen plan following the district office's approval of the specimen plan. Determination letters may be requested on Form 5307 for the adoption of such a plan.

.03 Fee Schedule. The amount of the user fee payable with respect to each category or subcategory of submission is as set forth in the following schedule. *User fees will not be required after September 30, 1990, unless legislation is enacted to extend the user fee program beyond September 30, 1990.*

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(1) Associate Chief Counsel (Technical) and Associate Chief Counsel (International) Rulings

	Requests Filed Through 3/31/90	*Requests Filed After 3/31/90*
(a) Except for reduced fees as provided in (b) below and exemptions provided in section 6.14, applications with respect to:		
Accounting Periods		
(i) Forms 1128 and 2553	$ 150	$ 200
(ii) Ruling requests for extensions of time under section 1.9100 of the regulations regarding Forms 1128, 2553, and 8716	$ 300	$ 500
Changes in Accounting Methods		
(i) Form 3115	$ 200	$ 500
(ii) Ruling requests for extensions of time under section 1.9100 of the regulations regarding Form 3115	$ 300	$ 500

NOTE: No user fee is required if the requested change in accounting method or accounting period is permitted to be made pursuant to a published automatic change revenue procedure. The automatic change revenue procedures published as of March 19, 1990, the date of publication of this revenue procedure, include Rev. Proc. 66-50, 1966-2 C.B. 1260; Rev. Proc. 68-41, 1968-2 C.B. 943; Rev. Proc. 74-11, 1974-1 C.B. 420; Rev. Proc. 84-34, 1984-1 C.B. 508; Rev. Proc. 85-36, 1985-2 C.B. 434; Rev. Proc. 85-37, 1985-2 C.B. 438; Rev. Proc. 85-54, 1985-2 C.B. 734; Rev. Proc. 87-29, 1987-1 C.B. 771; Rev. Proc. 87-32, 1987-2 C.B. 396; Rev. Proc. 88-15, 1988-1 C.B. 683; Rev. Proc. 89-16, 1989-1 C.B. 822, and Rev. Proc. 89-46, 1989-2 C.B. 597. Taxpayers complying timely with an automatic change revenue procedure will be deemed to have obtained the consent of the Commissioner of Internal Revenue to change either their accounting method of period.

All other rulings (which includes accounting period, accounting method, and earnings and profits requests other than those submitted on Forms 1128, 2553, 3115 and 5452)	$ 300	$2,500

(b) Reduced Fees

Ruling requests from individuals, trusts, and estates with a total income of less than $150,000 as reported on their federal income tax return (as amended) filed for a full (12 months) taxable year ending before the date the request is filed. In the case of a ruling request from an estate or trust that, at the time the ruling request is filed, has not filed an income tax return for a full taxable year, the reduced fee will be applicable if the decedent's or (in the case of an individual grantor) the grantor's gross income as reported on the last return filed for a full taxable year ending before the date of death, or the date of the transfer, is less than $150,000	N/A	$ 500
Ruling requests from organizations exempt from income tax under "Subchapter F-Exempt Organizations" of the Internal Revenue Code with gross receipts of less than $150,000	N/A	$ 500

NOTE: If there are two or more applicants filing the request, the total incomes of the applicants are to be combined in determining whether the combined total income is less than $150,000. If there are two or more organizations exempt from income tax under Subchapter F of the Code filing the request, the total gross receipts of the applicants are to be combined in determining whether the combined total gross receipts are less than $150,000. Also, an individual, trust, or estate seeking a reduced fee must certify in the request for a ruling that his, her, or its total income was less than $150,000 as reported on his, her, or its federal income tax return (as amended) for the last full taxable year before the date the request is filed. An organization exempt from income tax under Subchapter F of the Code seeking a reduced fee must certify in its request for a ruling that its gross receipts for the last full taxable year before the request was filed was less than $150,000.

(c) Possible Larger Fees for Certain Requests

Announcement 89-105, 1989-35 I.R.B. 20, answers a number of commonly asked questions concerning Rev. Proc. 89-34, including how the "comfort ruling" policy described therein is to be administered. Announcement 89-104, 1989-35 I.R.B. 19, requests public comment with respect to possible modifications of the "comfort ruling" policy. The public comments received in response to both announcements are now being evaluated and it is possible that the Service may decide to issue comfort rulings. If it does, consideration will be given to charging a higher user fee for them than the applicable fee set forth in (a) above.

(2) Employee Plans Ruling Letters, Opinion Letters, and Notification Letters

	Requests Filed Through 3/31/90	*Requests Filed After 3/31/90*
(a) *Rulings:*		
Except for reduced fees for "All Other Rulings" below and exemptions provided in section 6.14, applications with respect to:		
Computation of exclusion for annuitant under section 72	$ 50	$ 50
Change in plan year (Form 5308)	$ 150	$ 150

NOTE: No user fee is required if the requested ruling is permitted to be made pursuant to a published automatic change revenue procedure		
Change in funding method	$ 200	$ 275
Requests for approval to become a nonbank trustee (see section 1.401-12(n) of the Income Tax Regulations)	$1,000	$3,000
Waiver of minimum funding		
$1,000,000 and over	$1,000	$3,000
Under $1,000,000	$ 750	$1,500
Rulings under Rev. Proc. 89-35	N/A	$ 100
All other rulings	$ 400	$1,250
Reduced Fees:		
(i) Rulings requested by or on behalf of eligible retirement plans (within the meaning of section 402(a)(5)(E)-(iv) of the Code) with assets of less than $150,000	N/A	$ 500
(ii) Ruling requests from individuals, trusts and estates with a total income of less than $150,000 as reported on their federal income tax return (as amended) filed for a full (12 months) taxable year ending before the date the request is filed. In the case of a ruling request from an estate or trust that, at the time the ruling request is filed, has not filed an income tax return for a full taxable year, the reduced fee will be applicable if the decedent's or (in the case of an individual grantor) the grantor's gross income as reported on the last return filed for a full taxable year ending before the date of death, or the date of the transfer, is less than $150,000	N/A	$ 500
(iii) Ruling requests from organizations exempt from income tax under "Subchapter F-Exempt Organizations" of the Internal Revenue Code with gross receipts of less than $150,000	N/A	$ 500
NOTE: If there are two or more applicants filing the request, the total incomes of the applicants are to be combined in determining whether the combined total income is less than $150,000. If there are two or more organizations exempt from income tax under Subchapter F of the Code filing the request, the total gross receipts of the applicants are to be combined in determining whether the combined total gross receipts are less than $150,000. Also, an individual, trust, or estate seeking a reduced fee must certify in the request for a ruling that his, her, or its total income was less than $150,000 as reported on his, her, or its federal income tax return (as amended) for the last taxable year before the date the request is filed. In the case of a request by or on behalf of an eligible retirement plan, the plan administrator must certify that the plan's assets are less than $150,000. An organizations exempt from income tax under Subchapter F of the Code seeking a reduced fee must certify in its request for a ruling that its gross receipts for the last taxable year before the request was filed was less than $150,000.		
(b) Opinion and Advisory Letters on Master and Prototype Plans	*Requests Filed Through 9/30/90*	*Requests Filed After 9/30/90*
(The terms "mass submitter," "word-for-word identical adoption," and "minor modification" as used in this subcategory are explained in section 18 of Rev. Proc. 89-9.)		

Mass submission, per basic plan document (new or amended, regardless of number of adoption agreements)	$1,000	$3,000
Sponsoring organization's word-for-word identical adoption of mass submitter's basic plan document, per adoption agreement (mass submitters which are sponsoring organizations in their own right are liable for this fee)	$ 50	$ 100
NOTE: If a mass submitter submits, in any 12-month period ending January 31, more than 300 applications on behalf of word-for-word adopters with respect to a particular adoption agreement, only the first 300 such applications will be subject to the fee; no fee will apply to those in excess of the first 300 such applications submitted within the 12-month period.		
Sponsoring organization's minor modification of mass submitter's plan document, per adoption agreement (including a sponsor's request to change its employer identification number)	$ 400	$ 400
Nonmass submission by sponsoring organization, per adoption agreement	$1,000	$3,000
Sponsoring organization's adoption of model section 401(k) amendment, per adoption agreement	$ 100	N/A
Mass submitter's addition of optional provisions following issuance of a favorable opinion letter, per basic document (regardless of the number of adoption agreements)	$ 400	$ 400
(c) Notification Letters Issued by National Office on Regional Prototype Plans	*Requests Filed Through 9/30/90*	*Requests Filed After 9/30/90*
(The terms "mass submitter" and "word-for-word identical adoption" as used in this subcategory are explained in sections 4.05 and 9.03 of Rev. Proc. 89-13.)		
Mass submission of regional prototype plan, per basic plan document (new or amended, regardless of number of adoption agreements)	$1,000	$3,000
(d) Opinion Letters on Prototype Individual Retirement Accounts/Annuities and Simplified Employee Plans	*Requests Filed Through 9/30/90*	*Requests Filed After 9/30/90*
(The terms "mass submitter," "minor modification," and "word-for-word identical adoption," as used in this subcategory are explained in section 7 of Rev. Proc. 87-50.)		
Mass submission, per plan document, new or amended	$1,000	$1,000
Sponsoring organization's word-for-word identical adoption of mass submitter's prototype IRA or SEP, per plan document	$ 50	$ 100
NOTE: If a mass submitter submits, in any 12-month period ending January 31, more than 300 applications on behalf of word-for-word adopters with respect to a particular adoption agreement, only the first 300 such applications will be subject to the fee; no fee will apply to those in excess of the first 300 such applications submitted within the 12-month period.		
Sponsoring organization's minor modification of mass submitter's prototype IRA or SEP, per plan document	$ 400	$ 400
Nonmass submission by sponsoring organization, per plan document	$1,000	$ 500

(3) Exempt Organization Rulings	*Requests Filed Through 3/31/90*	*Requests Filed After 3/31/90*
Except for reduced fees as provided in "All Other Rulings" below and exemptions provided in section 6.14, applications with respect to:		
Change in accounting period (Form 1128)	$ 150	$ 150
NOTE: No user fee is charged if the procedure described in Rev. Proc. 85-58, 1985-2 C.B. 740, is used by timely filing the appropriate information return, or if the procedure described in Rev. Proc. 76-10, 1976-1 C.B. 548, for organizations with group exemptions is followed.		
Change in accounting method (Form 3115)	$ 200	$ 200
NOTE: No user fee is charged if the method described in Rev. Proc. 85-37, 1985-2 C.B. 438, is used. Taxpayers complying timely with that revenue procedure will be deemed to have obtained the consent of the Commissioner of Internal Revenue to change their method of accounting.		
Advance approval of scholarship grant-making procedures of a private foundation that has an agreement for the administration of the scholarship program with the National Merit Scholarship Corp., or similar organization administering a scholarship program shown to meet Service requirements	$ 100	$ 100
All other rulings	$ 400	$1,250
(i) Organizations with gross receipts less than $150,000:	$ 400	$ 500
(ii) Ruling requests from individuals, trusts, and estates with a total income of less than $150,000 as reported on their Federal income tax return (as amended) filed for a full (12 months) taxable year ending before the date the request is filed. In the case of a ruling request from an estate or trust that, at the time the ruling request is filed, has not filed an income tax return for a full taxable year, the reduced fee will be applicable if the decedent's or (in the case of an individual grantor) the grantor's gross income as reported on the last return filed for a full taxable year ending before the date of death, or the date of the transfer, is less than $150,000	$ 400	$ 500
NOTE: If there are two or more applicants filing the request, the total gross receipts or total incomes of the applicants are to be combined in determining whether the combined gross recipients or total income is less than $150,000. An exempt organization seeking a reduced fee must certify in the request for a ruling that its gross receipts for the last taxable year before the request is filed were less than $150,000. Individuals, trusts, estates, and taxable organizations seeking a reduced fee must certify that their total income as reported on their federal income tax return (as amended) for the last taxable year before the date the request was filed was less than $150,000.		

(4) Employee Plans Determination Letters, and Notification Letters and Advisory Letters Issued by Key District Offices	*Requests Filed Through 9/30/90*	*Requests Filed After 9/30/90*
Defined benefit and defined contribution plans, including requests involving (i) affiliated service groups under section 414(m) and (ii) leased employee arrangements under section 414(n) (Forms 5300 and 5301):		

Under 100 participants	$ 450	$ 700
100 or more participants	$ 750	$ 825
(For user fee purposes, the total number of participants referred to in this subcategory is the same as the number referred to on transmittal Form 8717, User Fee for Employee Plan Determination Letter Request.)		
Collectively bargained plans (Form 5303)	$ 550	$ 800
Multiple employer plans (Form 5300):		
2 to 10 employers	(See fees for	$ 700
11 to 99 employers	Forms 5300 and	$1,400
100 to 499 employers	5301 above)	$2,800
Over 499 employers		$5,600
Adopters of master and prototype plans, regional prototype plans, volume submitter plans, or other pre-approved plans as designated by the Assistant Commissioner (Employee Plans and Exempt Organizations) (Form 5307)	$ 100	$ 125
Short Amendments (Form 6406)	$ 100	$ 125
NOTE: This form cannot be used to request determination letters for restated plans or plans amended to comply with the Tax Reform Act of 1986.		
Terminating plans (Form 5310):		
Under 100 participants	$ 225	$ 225
100 or more participants	$ 450	$ 375
NOTE: The fee applies only if Form 5310 is being used to request a determination letter; it does not apply if the form is being used merely to notify the Service of a merger, consolidation or transfer of plan assets or liabilities. For user fee purposes, the total number of participants referred to in this subcategory is the same as the number referred to on transmittal Form 8717, User Fee for Employee Plan Determination Letter Request.		
Volume submitter specimen plans	$1,000	$1,500
NOTE: A practitioner that has received approval of a volume submitter specimen plan in a key district office must receive separate approval of the plan from each other key district office in which there are clients adopting substantially similar plans. If the practitioner certifies at the time of filing with the second key district office that its specimen plan is identical to a specimen plan approved by another key district office with respect to that practitioner and attaches a copy of that office's advisory letter, the user fee for volume submitter specimen plans will not be charged.		
Sponsor's identical adoption of mass submitter's regional prototype plan basic plan document, per adoption agreement (mass submitters that are sponsors in their own right are liable for this fee), Form 4461-B	$ 50	$ 100
Nonmass submission by sponsor of regional prototype plan, per adoption agreement, Form 4461 and Form 4461-A	$1,000	$1,500
Group trusts contemplated by Rev. Rul. 81-100, 1981-1 C.B. 326	$ 400	$ 750

(5) Exempt Organizations Determination Letters	*Requests Filed Through 9/30/90*	*Requests Filed After 9/30/90*
Initial application for exemption under section 501 from organizations (other than pension, profit-sharing, and stock bonus plans described in section 401) that have had annual gross receipts averaging not more than $10,000 during the preceding four years, or new organizations which anticipate gross receipts averaging not more than $10,000 during their first four years (Organizations seeking this reduced fee must sign a certification with their application that the receipts are or will be not more than the indicated amounts.)	$ 150	$ 150
Initial application for exempt status from organizations otherwise described above whose actual or anticipated gross receipts exceed the $10,000 average annually NOTE: If an organization that is already recognized as exempt under section 501(c) of the Code seeks reclassification under another subparagraph of section 501(c), a new user fee will be charged whether or not a new application is required. An additional fee applies also to organizations that seek recognition of exemption under section 501(c)(4) (unless requested at the time of the section 501(c)(3) application) for a period for which they do not qualify for exemption under section 501(c)(3) because their application was filed late and they do not qualify for relief under section 1.9100 of the Income Tax Regulations.	$ 300	$ 375
Request for final letter of termination of private foundation status	$ 200	$ 200
Group exemption letters	See $150 or $300 fees above for initial applications for exemption	$ 500

(6) Other Determination Letters	*Requests Filed Through 3/31/90*	*Requests Filed After 3/31/90*
Determination letters governed by Rev. Proc. 90-1 and Rev. Proc. 87-4 concerning income tax, estate tax, gift tax, excise tax, employment tax, and administrative matters	$ 200	$ 250

.04 *Submissions Involving Several Offices.* If a request dealing with only one transaction involves more than one of the offices within the National Office of the Service (for example, one issue is under the jurisdiction of the Associate Chief Counsel (Technical) and another issue is under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations)), only one fee applies, namely, the highest fee that otherwise would apply to each of the offices involved.

.05 *Submissions Involving Several Categories.* If a request dealing with only one transaction involves more than one category, only one fee applies, namely the highest fee that otherwise would apply to each of the categories involved.

.06 *Submissions Involving Several Issues.* If a request dealing with only one transaction involves several issues, only one fee applies, namely the fee that applies to the particular category or subcategory involved. The addition of a new issue relating to the same transaction will not result in an additional fee, except when the issue places the transaction in a higher fee category.

.07 *Submissions Involving Several Unrelated Transactions.* A separate fee will apply with respect to each unrelated transaction where a request involves several unrelated transactions or the request is changed by the addition of an unrelated transaction not contained in the initial submission.

.08 *Submissions Involving Several Entities.* Each entity involved in a transaction (for example, an exempt hospital reorganization) that desires a separate ruling letter in its own name must pay a separate fee regardless of whether the transaction or transactions may be viewed as related.

.09 *Method of Payment.* Each request to the Service for a ruling, determination letter or opinion letter must be accompanied by a check or money order, payable to the Internal Revenue Service, in the appropriate amount. (However, the user fee check or money order should not be attached to the Form 2553, Election by a Small Business Corporation, when it is filed at the Service Center. If on the Form 2553 the corporation requests a ruling that it be permitted to use a fiscal year under section 6.03 of Rev. Proc. 87-32, the Service Center

will forward such request to the National Office. When the National Office receives the Form 2553 from the Service Center, it will notify the requester that the fee is due.) Requesters should not send cash.

.10 *Mailing Address for Requesting Rulings, Determination Letters, etc.*

(1) A request for a ruling letter submitted pursuant to Rev. Proc. 90-1 should be sent to the Internal Revenue Service, Associate Chief Counsel (Technical), Attention: CC:CORP:T, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044. The package should be marked: RULING REQUEST SUBMISSION. Requests may be hand-delivered to Room 6561, 1111 Constitution Avenue, N.W., Washington, D.C., by 4:00 p.m. on business days; after 4:00 p.m., such requests may be deposited in the lock box located just within the entrance on the 12th Street side of the building.

(2) A request for a ruling letter submitted pursuant to Rev. Proc. 87-4 should be sent to the Internal Revenue Service, Associate Chief Counsel (International), Attention: CC:CORP:T, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044. The package should be marked: RULING REQUEST SUBMISSION. Requests may be hand-delivered to Room 6561, 1111 Constitution Avenue, N.W., Washington, D.C., or deposited in the lock box as described above.

(3) A request for a determination letter submitted pursuant to Rev. Proc. 90-1 or Rev. Proc. 87-4 should be sent to the District Director of Internal Revenue whose office has or will have examination jurisdiction over the requester's return.

(4) Requests for rulings, opinion letters, advisory letters, or notification letters (with respect to mass submitters' regional prototype plans) submitted pursuant to Rev. Proc. 78-37, 79-18, 79-61, 79-62, 83-41, 87-50, 89-9, 89-13 or 90-4 should be sent to the address set forth below. Such requests may be hand-delivered to Room 6052, 1111 Constitution Avenue, N.W., Washington, D.C., by 4:00 p.m. on business days; after 4:00 p.m., such requests may be deposited in the lock box as described above.

(a) *Employee Plans Rulings*

Internal Revenue Service
Assistant Commissioner (Employee Plans and Exempt Organizations)
Attention: E:EP:R
P.O. Box 14073, Ben Franklin Station
Washington, D.C. 20044

(b) *Exempt Organizations Rulings*

Internal Revenue Service
Assistant Commissioner (Employee Plans and Exempt Organizations)
Attention: E:EO
P.O. Box 120, Ben Franklin Station
Washington, D.C. 20044

(c) *Employee Plans Opinion Letters, Advisory Letters, or Notification Letters with respect to Mass Submitters' Regional Prototype Plans*

Internal Revenue Service
Assistant Commissioner (Employee Plans and Exempt Organizations)
Attention: E:EP:Q
P.O. Box 14073, Ben Franklin Station
Washington, D.C. 20044

(5) Requests for determination letters submitted pursuant to Rev. Procs. 80-30, 84-46, 89-9, 89-13 or 90-4, and requests for notification letters submitted pursuant to Rev. Proc. 89-13 (other than with respect to mass submitters' regional prototype plans) and requests for advisory letters with respect to volume submitter specimen plans should be sent to the following address:

If entity is in this IRS District	*Send request for determination letter, notification letter, or advisory letter to this address:*
For Employee Plans and Exempt Organizations	
Brooklyn, Albany, Augusta, Boston, Buffalo, Burlington, Hartford, Manhattan, Portsmouth, Providence	Internal Revenue Service EP/EO Division P.O. Box 1680,GPO Brooklyn, NY 11202
Baltimore, District of Columbia, Pittsburgh, Richmond, Newark, Philadelphia, Wilmington, any U.S. possession or foreign country	Internal Revenue Service EP/EO Division P.O. Box 17010 Baltimore, MD 21203
Atlanta, Birmingham, Columbia, Fort Lauderdale, Greensboro, Jackson, Jacksonville, Little Rock, Nashville, New Orleans	Internal Revenue Service EP/EO Division P.O. Box 941 Atlanta, GA 30370
Cincinnati, Cleveland, Detroit, Indianapolis, Louisville, Parkersburg	Internal Revenue Service EP/EO Division P.O. Box 3159 Cincinnati, OH 45201
Dallas, Albuquerque, Austin, Cheyenne, Denver, Houston, Oklahoma City, Phoenix, Salt Lake City, Wichita	Internal Revenue Service EP/EO Division Mail Code 4950 DAL 1100 Commerce Street Dallas, TX 75242

If entity is in this IRS District	*Send request for determination letter, notification letter, or advisory letter to this address:*
For Employee Plans Only	
Chicago, Aberdeen, Des Moines, Fargo, Helena, Milwaukee, Omaha, St. Louis, St. Paul, Springfield	Internal Revenue Service EP/EO Division 230 S. Dearborn DPN 20-6 Chicago, IL 60604
Honolulu, Laguna Niguel, Las Vegas, Los Angeles, San Jose	Internal Revenue Service EP Application Receiving Room 5127 P.O. Box 536 Los Angeles, CA 90053-0536
Sacramento, San Francisco	Internal Revenue Service EP Application Receiving Stop SF 4446 P.O. Box 36001 San Francisco, CA 94102
Anchorage, Boise, Portland, Seattle	Internal Revenue Service EP Application Receiving 999 3rd Ave., Suite 1940 Seattle, Washington 98104
For Exempt Organizations Only	
Chicago, Aberdeen, Des Moines, Fargo, Helena, Milwaukee, Omaha, St. Louis, St. Paul, Springfield	Internal Revenue Service EP/EO Division 230 S. Dearborn DPN 20-5 Chicago, IL 60604
Anchorage, Las Vegas, Boise, Los Angeles, Honolulu, Portland, Laguna Niguel, San Jose, Seattle	Internal Revenue Service EP/EO Application Receiving Room 5127 P.O. Box 486 Los Angeles, CA 90053-0486
Sacramento, San Francisco	Internal Revenue Service EO Application Receiving Stop SF 4446 P.O. Box 36001 San Francisco, CA 94102

.11 *Transmittal Forms.* Form 8717, User Fee for Employee Plan Determination Letter Request, and Form 8718, User Fee for Exempt Organization Determination Letter Request, are intended to be used as attachments to determination letter applications. Space is reserved for the attachment of the applicable user fee check or money order. No similar form has been designed to be used in connection with requests for National Office rulings, opinion letters or notification letters.

.12 *Effect of Nonpayment or Payment of Incorrect Amount.* It will be the general practice of the Service that:

(1) Except in the case of requests for determination letters or opinion letters as to the qualification of employee plans (see paragraph (2) below), the respective offices within the Service that are responsible for issuing rulings, determination letters, etc. will exercise discretion in deciding whether to immediately return submissions that are not accompanied by a properly completed check or money order or that are accompanied by a check or money order for less than the correct amount. In those instances where the submission is not immediately returned, the requester will be contacted and given a reasonable amount of time to submit the proper fee. If the proper fee is not received within a reasonable amount of time, the entire submission will then be returned. However, the respective offices of the Service, in their discretion, may defer substantive consideration of a submission until proper payment has been received.

(2) If a request for a determination letter or opinion letter as to the qualification of an employee plan is not accompanied by a properly completed check or money order (for example, a check has not been signed), or if the request is accompanied by a check or money order for less than the correct amount, the entire submission will be returned to the requester, along with the check or money order.

(3) An application for a determination letter will not be returned merely because Form 8717 or Form 8718 was not attached.

(4) The return of a submission to the requester may adversely affect substantive rights if the submission is

not perfected and resubmitted to the Service within 30 days of the date of the cover letter returning the submission. For example, where an application for a determination letter is submitted prior to the expiration of the remedial amendment period under section 401(b) of the Code and is returned because no user fee was attached, the submission will be timely if it is resubmitted by the expiration of the remedial amendment period or, if later, within 30 days after the application was returned.

(5) If a check or money order is for more than the correct amount, the submission will be accepted and the amount of the excess payment will be returned to the requester.

.13 *Refunds.* In general, the fee will not be refunded unless the Service declines to rule on all issues for which a ruling is requested.

(1) The following are examples of situations in which the fee will not be refunded:

(a) The request for a ruling, determination letter, etc. is withdrawn at any time subsequent to its receipt by the Service, unless the only reason for withdrawal is that the Service has advised the requester that a higher user fee than was sent with the request is applicable and the requester is unwilling to pay the higher fee.

(b) The request is procedurally deficient, although accompanied by the proper fee or an overpayment and is not timely perfected by the requester. Where there is a failure to timely perfect the request, the case will be considered closed and the failure to perfect will be treated as a withdrawal for purposes of this revenue procedure.

(c) A ruling, determination letter, etc. is revoked in whole or in part at the initiative of the Service. The fee paid at the time the original ruling, determination letter, etc. was requested will not be refunded.

(d) The request contains several issues and the Service rules on some, but not all, of the issues. The highest fee applicable to the issues on which the Service rules will not be refunded.

(e) The requester asserts that a ruling the requester received covering a single issue is erroneous or not responsive (other than with respect to any issue on which the Service has declined to rule) and requests reconsideration. The Service, upon reconsideration, does not agree that the ruling is erroneous or not responsive. The fee accompanying the request for reconsideration will not be refunded.

(f) The situation is the same as described in subparagraph (e) immediately above except that the ruling covered several unrelated transactions. The Service, upon reconsideration, does not agree with the requester that the ruling is erroneous or not responsive with respect to all of the transactions, but does agree that it is erroneous with respect to one transaction. The fee accompanying the request for reconsideration will not be refunded except to the extent applicable to the transaction with respect to which the Service agrees the ruling was in error.

(g) The request is for a supplemental ruling, determination letter, etc. concerning a change in facts (whether significant or not) relating to the transaction ruled on.

(h) The request is for reconsideration of an adverse or partially adverse ruling or a final adverse determination letter, and the requester submits arguments and authorities not submitted before the original ruling or determination letter was issued.

(2) The following are examples of situations in which the fee will be refunded:

(a) In a situation to which section 6.13(1)(h) above does not apply, the requester asserts that a ruling the requester received covering a single issue is erroneous or not responsive (other than with respect to any issue on which the Service declined to rule) and requests reconsideration. The Service agrees, upon reconsideration, that the ruling is erroneous or not responsive. The fee accompanying the requester's request for reconsideration will be refunded.

(b) In a situation to which section 6.13(1)(h) above does not apply, the requester requests a supplemental ruling, determination letter, etc. to correct a mistake that the Service agrees it made in the original ruling, determination letter, etc., such as a mistake in the statement of facts or in the citation of a Code section. Once the Service agrees that it made a mistake, the fee accompanying the request for the supplemental ruling will be refunded.

(c) The requester requests and is granted relief under section 7805(b) of the Code in connection with the revocation in whole or in part, of a previously issued ruling, determination letter, etc. The fee accompanying the request for relief will be refunded.

.14 *Exemptions.*

(1) The user fee requirement of this revenue procedure shall not apply to departments, agencies, or instrumentalities of the United States that certify that they are seeking a ruling, determination letter, opinion letter or similar letter on behalf of a program or activity funded by federal appropriations. The fact that a user fee is not charged shall have no bearing on whether an applicant is treated as an agency or instrumentality of the United States for purposes of any provision of the Internal Revenue Code.

(2) The user fee requirements of this revenue procedure shall not apply to requests as to whether a worker is an employee for federal employment taxes and income tax withholding purposes (chapters 21, 22, 23, and 24, subtitle C, of the Internal Revenue Code) submitted on Form SS-8, Information for Use in Determining Whether a Worker Is an Employee for Federal Employment Taxes and Income Tax Withholding, or its equivalent.

SEC. 7. QUESTIONS AS TO APPLICABILITY OF AMOUNT OF FEE PAID

A requester that believes the user fee charged by the Service for its request for a ruling, determination letter, etc. is either not applicable or incorrect and wishes to receive a refund of all or part of the amount paid (see *Refunds* in section 6.13 above) may request reconsideration and, if desired, the opportunity for an oral discussion by sending a letter to the Internal Revenue Service at the applicable Post Office Box or other address given in section 6.10 above. Both the incoming envelope and the letter requesting such reconsideration should be prominently marked "USER FEE RECONSIDERATION REQUEST." No user fee is required for such requests. The request should be marked for the attention of:

If the matter involves primarily:	*Mark for the attention of:*
Associate Chief Counsel (Technical) ruling requests submitted pursuant to Rev. Proc. 90-1	Assistant Chief Counsel ( ) (complete by using whichever of the following designations applies)
	(Corporate)
	(Financial Institutions and Products)
	(Employee Benefits & Exempt Organizations)
	(Income Tax and Accounting)
	(Passthroughs and Special Industries)
Associate Chief Counsel (International) ruling requests submitted pursuant to Rev. Proc. 87-4	Assistant Chief Counsel (International)
National Office Employee Plans Requests	
National Office Employee Plans Opinion Letter and Notification Letter Requests	Chief, Qualifications Branch E:EP:Q
Minimum Funding Waiver Requests and Requests under Rev. Proc. 89-35	Chief, Pension Actuarial Branch E:EP:PA
Computation of Exclusion Ratio under Section 72	Chief, General Actuarial Branch E:EP:GA
All Other National Office Employee Plans Ruling Requests	Chief, Rulings Branch E:EP:R
Employee Plans and/or Exempt Organizations Determination Letter Requests	Chief, Technical Staff_____ Key District Office (add name of key district handling the request)
National Office Exempt Organizations Ruling Requests	Chief, Rulings Branch E:EO:R
Determination Letter Requests Submitted Pursuant to Rev. Procs. 90-1 or 87-4	Chief, Examination Division _____ District Office (add name of district office handling the request)

SEC. 8. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 89-4 is superseded.

.02 Rev. Procs. 80-30, 84-46, 84-86, 87-4, 87-50, 89-9, 89-13, 89-35, 90-1 and 90-4 are modified and amplified to the extent that this revenue procedure provides for an additional requirement that must be satisfied in requesting a ruling letter, determination letter, opinion letter, or notification letter pursuant to this revenue procedure.

SEC. 9. EFFECTIVE DATE

This revenue procedure is effective as of the date of its publication in the Internal Revenue Bulletin.

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, Section 6212; 301.6212-1.)

Rev. Proc. 90-18

SECTION 1. PURPOSE

This revenue procedure explains how a taxpayer is to inform the Internal Revenue Service of a change of address. When so informed, the Service will update the taxpayer's address of record to the new address. The Service uses the taxpayer's address of record for the various notices that are required to be sent to a taxpayer's "last known address" under the Internal Revenue Code and for refunds of overpayments of tax.

SEC. 2. SCOPE

.01 This revenue procedure applies to notices that are required to be sent to a taxpayer's "last known address" under the following sections of the Code:

Section 982(c)(1)
(formal document request for the production of foreign-based documentation);

Section 6110(f)(3)(B)
(notification of disclosure proceedings);

Section 6212(b)
(notice of deficiency);

Section 6303(a)
(notice and demand for tax);

Section 6325(f)(2)(A)
(notice of revocation of certificate of release or nonattachment of a lien);

Section 6331(d)(2)(C)
(notice of intention to levy);

Section 6332(b)(1)
(copy of notice of levy with respect to a life insurance or endowment contract);

Section 6335(a) and (b)
(notices of seizure and sale);

Section 6901(g)
(notice of liability in transferee cases); and

Section 7609(a)(2)
(notice of third-party summons).

.02 The Service generally will use the address on the most recently filed and properly processed return as the address of record for all the notices set forth in section 2.01 above. If a taxpayer no longer wishes the address of record to be the address on the most recently filed return, the taxpayer must give clear and concise written notification as provided by this revenue procedure. The terms "return," "properly processed," "address on return," and "clear and concise writ-

ten notification" are defined in section 5 below.

.03 Because the Service maintains address records under taxpayer identification numbers, notification of a change of address should include all taxpayer identification numbers (social security numbers and/or employer identification numbers) used by the taxpayer. Also, because the Service maintains address records for gift, estate, and generation-skipping transfer tax returns separate from the records it maintains for individual income tax returns, an individual taxpayer's notification of a change of address should identify whether any gift, estate, or generation-skipping transfer tax returns are affected by the notification.

SEC. 3. BACKGROUND

.01 The Code sections listed in section 2.01 of this revenue procedure use the phrase "last known address." Although this phrase is not defined in either the Code or the Treasury Regulations, its intended purpose can be found in the legislative history of a predecessor to section 6212(b) of the Code which provides that the purpose of imposing a last known address standard was to relieve the Service of the obviously impossible task of keeping an up-to-date record of taxpayers' addresses. H.R. Rep. No. 2, 70th Cong., 1st Sess. 22 (1927), 1939-1 (Part 2) C.B. 384, 399.

.02 The phrase "last known address" does not necessarily mean the taxpayer's actual address but instead means the last address that the taxpayer makes known to the Service. The meaning of this phrase is important, and taxpayers should be aware of their need to update their address with the Service in order to receive refunds of tax and the notices listed in section 2.01 of this revenue procedure. When such a notice is sent to a taxpayer's "last known address," the notice is legally effective even if the taxpayer never receives it.

.03 The Tax Court in *Abeles v. Commissioner*, 91 T.C. 1019 (1988), acq. 1989-2 C.B. 1, established certainty for the Service and for taxpayers in the determination of a taxpayer's "last known address" by setting forth the methods taxpayers are to use to inform the Service of a new address. *Abeles* held that the address on the most recently filed and properly processed return is the taxpayer's "last known address," unless the Service has been given clear and concise notification of a different address.

SEC. 4. PROCEDURES FOR CHANGE OF ADDRESS

.01 If a taxpayer files a return with new address information, the proper processing of the return will update the taxpayer's address of record. With the exception of the returns listed in section 4.04, a taxpayer's address of record will be updated for the name and taxpayer identification number (the employer identification number or the social security number) under which the return is filed.

.02 If a taxpayer no longer wishes the address of record to be the one shown on the most recently filed return, for instance, because the taxpayer moved after the return was filed, clear and concise written notification of a change of address must be sent to the Internal Revenue Service Center serving the taxpayer's old address or to the Chief, Taxpayer Service Division in the local district office. The Service is currently developing a new form (Form 8822) that taxpayers will be able to use to send clear and concise written notification of a change of address pursuant to this revenue procedure.

.03 If after a joint return is filed either taxpayer establishes a separate residence, each taxpayer should send clear and concise written notification of a current address to the Service as provided in section 4.02 above.

.04 The Service maintains address records for gift, estate, and generation-skipping transfer tax returns (Forms 706, 706-A, 706NA, 709, and 709-A) separate from the address records for individual income tax returns (Forms 1040, 1040A, 1040EZ, 1040NR, 1040-PR, 1040SS, and 1040X). Thus, an individual taxpayer's notification of a change of address should identify whether any gift, estate, or generation-skipping transfer tax returns are affected by the notification.

.05 If a Service employee contacts a taxpayer in connection with the filing of a return or an adjustment in the taxpayer's account, the taxpayer may provide clear and concise written notification of a change of address to the Service employee who initiated the contact. If contact was not initiated by a Service employee, clear and concise written notification is to be given as provided in section 4.02 above.

.06 A taxpayer should notify the U.S. Postal Service facility serving the taxpayer's old address of the taxpayer's new address in order that mail from the Service can be forwarded to the new address. However, notification to the U.S. Postal Service does not constitute the clear and concise written notification that is required to change a taxpayer's address of record with the Service.

SEC. 5. DEFINITIONS

.01 Return. For purposes of updating a taxpayer's address of record, the term "return" includes the following federal tax or information forms:

(1) Returns filed under a social security number:

(a) Individual income tax returns:

Form 1040
U.S. Individual Income Tax Return;

Form 1040A
U.S. Individual Income Tax Return;

Form 1040EZ
Income Tax Return for Single Filers With No Dependents;

Form 1040NR
U.S. Nonresident Alien Income Tax Return;

Form 1040-PR
Planilla Para La Declaración De La Contribución Federal Sobre El Trabajo Por Cuenta Propia—Puerto Rico;

Form 1040SS
U.S. Self-Employment Tax Return—Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands (CNMI);

Form 1040X
Amended U.S. Individual Income Tax Return;

(b) Gift, estate, and generation-skipping transfer tax returns:

Form 706
United States Estate (and Generation-Skipping Transfer) Tax Return;

Form 706-A
United States Additional Estate Tax Return;

Form 706NA
United States Estate (and Generation-Skipping Transfer) Tax Return, Estate of nonresident not a citizen of the United States;

Form 709
United States Gift (and Generation-Skipping Transfer) Tax Return;

Form 709-A
United States Short Form Gift Tax Return;

(2) Returns filed under an employer identification number:

Form CT-1
Employer's Annual Railroad Retirement and Unemployment Repayment Tax Return;

Form 720
Quarterly Federal Excise Tax Return;

Form 940
Employer's Annual Federal Unemployment (FUTA) Tax Return;

Form 940-EZ
Employer's Annual Federal Unemployment (FUTA) Tax Return;

Form 940PR
Planilla Para La Declaración Anual Del Patrono—La Contribución Federal Para el Desempleo (FUTA);

Form 941
Employer's Quarterly Federal Tax Return;

Form 941c
Statement to Correct Information Previously Reported on the Employer's Federal Tax Return;

Form 941 E
Quarterly Return of Withheld Federal Income Tax and Hospital Insurance (Medicare) Tax;

Form 941c PR
Planilla Para La Corrección De Información Facilitada Anteriormente En Cumplimiento Con La Ley Del Seguro Social;

Form 941 PR
Planilla Para La Declaración Trimestral Del Patrono—La Contribución Federal Al Seguro Social;

Form 941SS
Employer's Quarterly Federal Tax Return;

Form 942
Employer's Quarterly Tax Return for Household Employees;

Form 942PR
Planilla Para La Declaración Trimestral Del Patrono De Empleados Domésticos;

Form 943
Employer's Annual Tax Return for Agricultural Employees;

Form 943 PR
Planilla Para La Declaración Anual De La Contribución Del Patrono De Empleados Agrícolas;

Form 990
Return of Organization Exempt from Income Tax (Except Black Lung Benefit Trust or Private Foundation);

Form 990-C
Farmers' Cooperative Association Income Tax Return;

Form 990-EZ
Short Form Return of Organization Exempt From Income Tax;

Form 990-PF
Return of Private Foundation or Section 4947(a)(1) Trust Treated as a Private Foundation;

Form 990-T
Exempt Organization Business Income Tax Return;

Form 1041
U.S. Fiduciary Income Tax Return;

Form 1042
Annual Withholding Tax Return for U.S. Source Income of Foreign Persons;

Form 1066
U.S. Real Estate Mortgage Investment Conduit Income Tax Return;

Form 1120
U.S. Corporation Income Tax Return;

Form 1120-A
U.S. Corporation Short-Form Income Tax Return;

Form 1120-DF
U.S. Income Tax Return for Designated Settlement Funds (Under section 468B);

Form 1120F
U.S. Income Tax Return of a Foreign Corporation;

Form 1120-FSC
U.S. Income Tax Return of a Foreign Sales Corporation;

Form 1120-H
U.S. Income Tax Return for Homeowners Associations;

Form 1120L
U.S. Life Insurance Company Income Tax Return;

Form 1120-ND
Return for Nuclear Decommissioning Funds and Certain Related Persons;

Form 1120-PC
U.S. Property and Casualty Insurance Company Income Tax Return;

Form 1120-POL
U.S. Income Tax Return for Certain Political Organizations;

Form 1120-REIT
U.S. Income Tax Return for Real Estate Investment Trusts;

Form 1120-RIC
U.S. Income Tax Return for Regulated Investment Companies;

Form 1120X
Amended U.S. Corporation Income Tax Return;

Form 2290
Heavy Vehicle Use Tax Return; and

Form 5227
Split-Interest Trust Information Return.

(3) The term "return" includes substitute forms (as defined in Rev. Proc. 90-8, page 434, this Bulletin, reprinted in IRS Publication 1167, or as defined in other current revenue procedures concerning the requirements for substitute forms) for those forms listed in section 5.01(1) and (2) above.

(4) The term "return" does not include applications for extension of time to file a return. Thus, for example, a new address listed on Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, will not be used by the Service to update the taxpayer's address of record.

.02 *Properly processed.*

(1) Except as otherwise provided by the exceptions below, a return will be considered properly processed after a 45-day processing period which begins the day after the date of receipt of the return by the Internal Revenue Service Center. However, if a return is received prior to the due date for the return, the 45-day processing period will begin the day after the due date of the return. Returns that are not filed in a processible form may require additional processing time. In such cases, the 45-day processing period for address changes will begin the day after the error that caused the return to be unprocessible is corrected.

(2) Due to the high volume of returns received during the filing season, if a taxpayer provides new address information on a Form 1040, 1040A, 1040EZ, 1040NR, 1040-PR, 1040SS, or 1040X, that is received by the Service after February 14 and before June 1, the return will be considered properly processed on July 16.

(3) A clear and concise written notification of a change of address will be considered properly processed after a 45-day processing period which begins the day after the date of receipt by:

(a) the Internal Revenue Service Center serving the taxpayer's old address;

(b) the Chief, Taxpayer Service Division in the local district office; or,

(c) a Service employee who contacted the taxpayer in connection with the filing of a return or an adjustment in the taxpayer's account.

(4) When the processing of address change information on a particular return will require a processing time in excess of 45 days, such as in section 5.02(2), taxpayers may send clear and concise written notification of a change of address to the Service in accordance with section 5.02(3) above.

.03 *Address on Return.* The "address on return" is the address information shown in the upper portion of the front page of the return. When a taxpayer files an electronic/magnetic media return, the address information on the electronic/magnetic media portion of the return will be used to update the taxpayer's address of record. Although the electronic/magnetic media return includes a Form 8453 series declaration, the declaration is not used by the Service to update the taxpayer's address of record.

.04 *Clear and Concise Written Notification.*

(1) Clear and concise written notification is a statement signed by the taxpayer informing the Service that a taxpayer wishes the address of record changed to a new address. In addition to the new address, this notification must contain the taxpayer's full name, signature, old address, and social security number and/or employer identification number. Filers of a joint return should provide both names, social security numbers, and signatures. Individuals that have changed last names, for instance, due to marriage, should provide the last name shown on the most recently filed return and the new last name. In all cases, clear and concise written notification must be specific as to a change of address. Thus, a new address reflected in the letterhead of taxpayer correspondence will not by itself change a taxpayer's address of record.

(2) If correspondence sent by the Service that solicits or requires a response by the taxpayer is returned to the Service by the taxpayer with corrections marked on the taxpayer's address information, the correspondence will constitute clear and concise written notification of a change of address. The taxpayer's signature on the correspondence is not required.

(3) The Service is currently developing a new form (Form 8822) that taxpayers will be able to use to send clear and concise written notification of a change of address pursuant to this revenue procedure.

SEC. 6. AREAS NOT COVERED BY THIS REVENUE PROCEDURE

.01 This revenue procedure does not apply to the notice requirements under sections 6221 through 6245 of the Code concerning the tax treatment of partnership and subchapter S items.

.02 This revenue procedure does not apply to the following returns because they have unique processing requirements:

Form 5330
Return of Excise Taxes Related to Employee Benefits Plans;

Form 5500
Annual Return/Report of Employee Benefit Plan (with 100 or more participants);

Form 5500-C/R
Return/Report of Employee Benefit Plan (with fewer than 100 participants); and

Form 5500EZ
Annual Return of One-Participant Owners and Their Spouses Pension Benefit Plan.

.03 This revenue procedure does not require the Service to send notices to an address furnished by the taxpayer when it is determined that a taxpayer cannot actually be contacted or located at that address.

SEC. 7. INQUIRIES

Inquiries regarding this revenue procedure should be addressed to the Assistant Chief Counsel (Income Tax and Accounting), Attention CC:IT&A:3, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224.

SEC. 8. EFFECTIVE DATE

This revenue procedure is effective March 26, 1990, the date of its publication.

26 CFR 601.202: Closing agreements.
(Also Part I, Section 897; 1.897-5T.)

Rev. Proc. 90-19

SECTION 1. PURPOSE

This revenue procedure provides a procedure for certain foreign corporations, that would otherwise be subject to gain recognition on the distribution of certain U.S. real property interests under section 1.897-5T(c)(2)(ii)(B) of the Income Tax Regulations, to obtain nonrecognition on the distribution by entering into a closing agreement under section 7121 of the Internal Revenue Code.

SEC. 2. BACKGROUND

Section 897(d)(1) of the Code and section 1.897-5T(c)(1) of the temporary regulations generally require that, if a foreign corporation makes a distribution (including a distribution in liquidation under section 332(a)) of a United States real property interest (USRPI) as defined in section 897(c)(1) to a shareholder, then the foreign corporation must recognize any gain (but not loss) on the distribution. The gain recognized is the excess of the fair market value of the USRPI at the time of the distribution over its adjusted basis. Section 1.897-5T(c)(2) contains an exception to the gain recognition rule of section 1.897-5T(c)(1) that applies to liquidation distributions under section 332(a) of USRPIs to a domestic or foreign corporation meeting the stock ownership requirements of section 332(b) if certain conditions are met. However, this exception is not available in the case of a distribution to a domestic corporation where there have been certain dispositions of the stock of the distributing foreign corporation within five years of a liquidation distribution to a domestic corporation.

Notice 89-85, 1989-2 C.B. 403, revises the exception in section 1.897-5T(c)(2) and provides that, in the case of a distribution to a domestic corporation, the exception to the gain recognition rule in section 1.897-5T(c)(1) will apply only if the distributing foreign corporation pays an amount equal to any taxes that section 897 would have imposed (together with interest that would have accrued) upon all persons who disposed of interests in the foreign corporation (or a corporation from which the distributed USRPI(s) were acquired in a transaction described in section 381) after June 18, 1980, if the foreign corporation had been a domestic corporation on the date of each of such dispositions. Certain other requirements not relevant here must also be satisfied.

Notice 89-85 applies to section 332 distributions of USRPIs by foreign corporations to domestic corporations that occur after July 31, 1989. However, a distributing foreign corporation may choose instead to apply the rules of the current temporary regulations to such a distribution where the distributee corporation owned stock in the distributing foreign corporation satisfying the requirement of section 332(b) on July 31, 1989.

SEC. 3. SCOPE

If a foreign corporation, within the 5-year period described in section 1.897-5T(c)(2)(ii)(B)(2), distributes in a liquidation under section 332(a) a USRPI to a domestic corporation that met the ownership requirements of section 332(b) with respect to the distributing foreign corporation on July 31, 1989, and the distributing foreign corporation owned the USRPI on July 31, 1989, then the distributing foreign corporation shall not be required to recognize gain under section 1.897-5T(c)(2)(ii)(B) of the temporary regulations if the requirements of section 4 of this revenue procedure are met.

SEC. 4. PROCEDURE

01. The requirements of section 1.897-5T(c)(2)(i) of the temporary regulations must be met;

02. Before the distribution in liquidation under section 332(a), the distributee domestic corporation and the distributing foreign corporation must request relief in a private letter ruling application submitted to the Office of the Associate Chief Counsel (International), and the ruling application must include a statement and supporting facts indicating that the liquidation is necessary to integrate trades or businesses actively conducted within the United States; and

03. Before the distribution in liquidation under section 332(a), the distributee domestic corporation and the distributing foreign corporation must enter into a closing agreement with the Service under section 7121 with appropriate terms and conditions, including terms and conditions relating to the recognition of gain upon any disposition of the USRPI or of the stock of the distributee domestic corporation within five years after the date of the last gain from the disposition of stock described in section 1.897-5T(c)(2)(ii)(B)(2) (other than certain dispositions specified in the closing agreement as determined within the discretion of the Service).

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 90-20

SECTION 1. PURPOSE

This revenue procedure sets forth special procedures of the Internal Revenue Service pertaining to the issuance of determination letters on the qualified status of certain ongoing pension, profit-sharing, and annuity plans under sections 401 and 403(a) of the Internal Revenue Code, as amended by the Tax Reform Act of 1986 (TRA '86), Pub. L. 99-514, 1986-3 (Vol. 1) C.B. 1, the Omnibus Budget Reconciliation Act of 1986 (OBRA '86), Pub. L. 99-509, the Omnibus Budget Reconciliation Act of 1987 (OBRA '87), Pub. L. 100-203, the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. 100-647, and the Omnibus Budget Reconciliation Act of 1989 (OBRA '89), Pub. L. 101-239, and pertaining to the status of any related trusts or custodial accounts under section 501(a). These special procedures are in addition to the Service's general determination letter procedures under Rev. Proc. 80-30, 1980-1 C.B. 685.

SEC. 2. OVERVIEW

This revenue procedure provides that on or after April 30, 1990, certain ongoing defined contribution plans may file for determination letters that include consideration of the changes made by TRA '86, OBRA '86, OBRA '87, TAMRA, and OBRA '89 (collectively, "TRA"). Section 3 lists and provides a brief summary of

other revenue procedures and notices relating to the determination letter program. Section 4 describes the types of plans that may be submitted for these determination letters and provides general guidance for employers with other types of plans. Section 5 provides general application instructions. Section 6 provides special application rules for applicants who want a determination on Internal Revenue Code section 401(a)(26) minimum participation requirements. Sections 7 and 8 provide special rules for adopters of master or prototype, regional prototype, and volume submitter plans, and for multiple employer plans. Finally, section 9 makes corresponding modifications to other revenue procedures on the determination letter program. The Service will extend this determination letter program beyond plans described in section 4 as soon as possible after the issuance of necessary guidance, particularly regarding the nondiscrimination requirements of section 401(a)(4).

SEC. 3. BACKGROUND AND GENERAL INFORMATION

.01 Rev. Proc. 80-30 sets forth the general procedures of the Service relating to the issuance of determination letters on the qualification of pension, profit-sharing, stock bonus, and annuity plans, including determination letters involving the termination of such plans.

.02 Notice 86-13, 1986-2 C.B. 377, provides that, until further notice, determination letter requests concerning qualification of pension, profit-sharing, stock bonus, and annuity plans will not be reviewed for qualification requirements changed by TRA '86, other than certain retroactive technical corrections.

.03 Rev. Proc. 88-42, 1988-2 C.B. 613, sets forth special procedures pertaining to the issuance of determination and notification letters regarding the qualified status of plans that contain provisions of TRA '86, OBRA '86, and OBRA '87 that are effective for plan years beginning before January 1, 1989. Under Rev. Proc. 88-42, plan sponsors that submit an application for a determination letter on or after September 12, 1988 may request that the determination letter reflect consideration of the qualification requirements as they are in effect for plan years beginning before 1989.

.04 Notice 87-57, 1987-2 C.B. 368, and Rev. Proc. 88-9, 1988-1 C.B. 634, set forth special procedures pertaining to the issuance of determination letters on the qualification of pension, profit-sharing, stock bonus, and annuity plans that will be terminated prior to the delayed amendment date provided in section 1140 of TRA '86. In order to receive a favorable determination letter upon termination, Notice 87-57 and Rev. Proc. 88-9 require a qualified plan terminating prior to the delayed amendment date of section 1140 to be amended to reflect the law in effect at the time of termination.

.05 Rev. Proc. 89-9, 1989-1 C.B. 780, sets forth the procedures of the Service pertaining to the issuance of opinion letters for master and prototype (M&P) pension, profit-sharing, and annuity plans under sections 401 and 403(a) of the Code as amended by TRA '86, OBRA '86, OBRA '87, and TAMRA.

.06 Rev. Proc. 89-13, 1989-1 C.B. 801, sets forth the procedures of the Service pertaining to the issuance of notification letters for regional prototype defined contribution and defined benefit plans.

.07 Announcement 89-107, 1989-36 I.R.B. 25, provides information pertaining to the approval of volume submitter specimen pension and profit-sharing plans under TRA '86.

.08 Rev. Proc. 89-65, 1989-2 C.B. 786, extends the remedial amendment period under section 401(b) of the Code within which a plan must be amended to comply with the requirements of TRA '86, OBRA '86, OBRA '87, and TAMRA until the end of a plan's 1991 plan year. In addition, Rev. Proc. 89-65 provides that the Service will begin accepting applications for determination letters in early 1990 (concurrent with the issuance of the revised Form 5300 (which will combine current Forms 5300 and 5301), Form 5303, and Form 5307).

.09 Announcement 89-154, 1989-50 I.R.B. 16, provides that the Service will begin issuing opinion, notification, and advisory letters regarding the acceptability of M&P, regional prototype and volume submitter specimen defined contribution plans (other than target benefit plans) under TRA on January 4, 1990.

.10 Rev. Proc. 90-17, page 479, this Bulletin, sets forth procedures relating to the payment of user fees for requests to the Service for rulings, determination letters, and similar requests.

SEC. 4. APPLICABILITY OF PROCEDURE

.01 If requested by the applicant in accordance with section 5, an application for determination of the qualified status of an ongoing plan described in subsection .02 that is filed with the Service on or after April 30, 1990 will be reviewed by the Service for compliance with the requirements of TRA, including those requirements that are first effective for plan years beginning on or after January 1, 1989.

.02 A plan is described in this subsection if (i) it is an adoption of a pre-approved plan (i.e., an M&P, regional prototype, or volume submitter plan that has received a favorable opinion, notification, or advisory letter on or after January 4, 1990) or an individually designed plan and (ii) if all of the following requirements are met by the plan or the employer(s) maintaining the plan:

(1) the plan is a defined contribution plan (other than a target benefit plan, a stock bonus plan, an ESOP, or a plan under which the test for prohibited discrimination under section 401(a)(4) of the Code is made by reference to benefits rather than contributions);

(2) the employer is not using the average benefit percentage test under section 410(b)(2) of the Code to demonstrate that the minimum coverage requirements are met by the plan or any other plan with which it would have to be aggregated under section 1.410(b)-7(e) of the proposed regulations;

(3) the employer is not applying the line of business exception under section 410(b)(5) for purposes of determining whether the minimum coverage requirements are met;

(4) if the plan provides for disparity in contributions that favors highly compensated employees, the disparity satisfies the requirements of section 401(l), the proposed regula-

tions thereunder, and Notice 89-70, 1989-1 C.B. 730; and

(5) the plan does not rely on any other plan to satisfy the minimum coverage requirements of section 410(b) or the nondiscrimination requirements of section 401(a)(4).

.03 Any application relating to an ongoing plan described above that is submitted prior to April 30, 1990 will be reviewed in accordance with the procedures contained in Rev. Proc. 88-42 or Notice 86-13, as applicable, unless the applicant chooses to withdraw the application. Regardless of whether the earlier application has been withdrawn, the applicant must file a new application in accordance with this revenue procedure to receive a determination letter that considers all requirements of TRA. The Service will not refund any user fee paid with the earlier application, but the applicant may be entitled to relief from imposition of a user fee on the new application under section 5.06.

.04 Until further notice, determination letter applications for ongoing plans that are not described above will continue to be reviewed and processed in accordance with Notice 86-13 or Rev. Proc. 88-42, as applicable. These applications must be filed on the most recent version of the applicable form with a revision date prior to January, 1990.

.05 Because of the extension of the remedial amendment period provided in Rev. Proc. 89-65, no ongoing qualified plan is required to be amended for TRA until the end of the first plan year beginning after December 31, 1990. Therefore, sponsors of plans not described above who have not yet submitted determination letter applications should consider delaying the submission of these applications until they can be reviewed for compliance with all requirements of TRA.

.06 This revenue procedure does not apply to determination letter requests involving terminating plans. The Service will continue to accept applications for these plans in accordance with Notice 87-57 and Rev. Proc. 88-9.

SEC. 5. GENERAL INSTRUCTION TO SPONSORS

.01 The instructions in this section apply in all cases in which an applicant seeks a determination of the qualified status of an ongoing plan described in section 4.02 that considers all requirements of TRA.

.02 The applicant must include with its application a certification (separate from any cover letter submitted with the application) in which the applicant or the applicant's representative certifies that the requirements set forth in section 4.02 are met by the plan or the employer maintaining the plan. In the case of a plan that is not a single employer plan, the applicant or representative must certify that the requirements are met by the plan and each participating employer.

.03 If the plan has received a favorable determination letter in the past, the application must also include a copy of the latest determination letter, if available. If the letter is not available, an explanation must be included in a cover letter.

.04 The application form that is used to request a determination letter under this revenue procedure must have a revision date of January, 1990, or later ("new form"). An application that is not submitted under this revenue procedure (i.e. an application submitted pursuant to Notice 86-13 or Rev. Proc. 88-42) must be filed on the most recent version of the form with a revision date before January, 1990. The following new forms are required to be filed for applications for determination letters under this revenue procedure regardless of whether the application relates to the initial qualification or amendment of a plan:

Individually Designed Plan (other than collectively bargained)	Form 5300, Application for Determination for Employee Benefit Plan
M&P, Regional Prototype or Volume Submitter Plan (other than a request for determination of affiliated group status or whether the employer receives services from leased employees)	Form 5307, Application for Determination for Adopters of Master or Prototype, Regional Prototype, or Volume Submitter Plans
M&P, Regional Prototype or Volume Submitter Plan (involving a request for determination of affiliated group status or whether the employer receives services from leased employees)	Form 5300
Collectively Bargained Plan	Form 5303, Application for Determination for Collectively Bargained Plan

(Note: At the time of publication of this revenue procedure, the new Form 5303 is not available to the public. Therefore, applications under this revenue procedure for collectively bargained plans will not be accepted until the new Form 5303 is available.)

.05 In general, applications filed under this revenue procedure must include a Form 5302, Employee Census, revised January, 1990, or later. However, a Form 5302 need not be filed for a collectively bargained plan that does not cover any employees who are not included in the collective bargaining unit or any employees of the representative labor union or the plan.

.06 Applications filed under this revenue procedure must include the appropriate user fee determined under Rev. Proc. 90-17, and should include Form 8717, User Fee for Employee Plan Determination Letter Requests. However, a user fee will not be required for an application relating to an ongoing plan described in section 4.02 that is filed under this revenue procedure if the applicant has previously paid a user fee for a determination letter application involving the

same plan and one of the following conditions is met:

1 The prior application was filed before April 9, 1990, and was still pending with the Service on that date.

2 The prior application was filed on or after April 9, 1990, but was not filed on a new form in accordance with this procedure.

In order to avoid the imposition of an additional user fee on the new application, the applicant must certify that a user fee was previously paid and that one of the above conditions has been met by printing "Application Eligible for Waiver of User Fee Under Rev. Proc. 90-20" in bold letters on the top of the first page of the new application form.

.07 Requests for determination letters for ongoing plans that are submitted on or after April 30, 1990 on the proper new form but are not accompanied by the certification required by section 5.02 will be returned without further review. In this case, the applicant will have the opportunity to perfect the application.

.08 In the case of an initial submission under this revenue procedure for a plan other than an M&P or regional prototype plan, the application must include a copy of the restated plan. Pages of amendments, in lieu of the restated plan, will not be accepted. The effective dates for required amendments must be clearly identified.

SEC. 6. SPECIAL RULES THAT APPLY TO DETERMINATIONS INVOLVING MINIMUM PARTICIPATION REQUIREMENTS

Section 401(a)(26) of the Code and the proposed regulations thereunder generally require a plan that benefits active employees to benefit at least the lesser of 50 active employees or 40 percent of all nonexcludable active employees of the employer. A determination letter issued under this revenue procedure will not consider whether the plan meets this requirement unless the applicant requests consideration of this issue on the application form. To receive a determination that the plan meets this requirement, the applicant must also submit information with the application that demonstrates compliance with the section 401(a)(26) minimum participation test for active employees. For example, there must be a demonstration that the plan and separate benefit structures in the plan, if any, comply with section 401(a)(26). This may be done either by showing that 50 active employees or 40 percent of the employer's active employees benefit under the plan or separate benefit structure, or by showing that the plan or benefit structure satisfies one of the applicable exceptions or special rules. For purposes of identifying current benefit structures under the plan, the applicant may use the transition rule for current benefit structures provided in the proposed regulations. The transition rule may be used for plan years beginning before the later of (i) January 1, 1992, or (ii) 60 days after the final regulations under section 401(a)(26) are published in the Federal Register, as long as the application for the determination letter is filed by the last day of such plan year.

SEC. 7. SPECIAL RULES FOR M&P, REGIONAL PROTOTYPE, AND VOLUME SUBMITTER PLANS

.01 In general, an employer that adopts a standardized M&P or regional prototype plan need not request a determination letter as to the qualified status of the plan. However, if the employer has, at any time, maintained another plan in addition to the standardized plan or adopts another plan, other than another standardized plan of the same sponsor that is designed to satisfy Code sections 401(a)(4), 415, and 416 when adopted in conjunction with the employer's plan (i.e., a paired plan), then the employer must file an application for a determination letter under section 5 in order to be entitled to reliance that the plan complies with the requirements of section 415 of the Code.

.02 All applications for determination letters submitted by M&P or regional prototype plan adopters must be accompanied by a copy of the adoption agreement. In addition, an application involving a regional prototype plan that uses separate trust or custodial account documents must include copies of these documents.

.03 All applications for determination letters submitted by adopters of Service approved volume submitter plans must be accompanied by a copy of the plan and trust instrument and by a written representation, made by the volume submitter, that explains how the plan and trust instrument differ from the approved specimen plan, specifying the location, nature and effect of each difference. The extent to which the plan and trust instrument may differ from the approved specimen plan is governed by the procedures of the appropriate Key District Office.

.04 All applications submitted by adopters of M&P, regional prototype, or volume submitter plans must also be accompanied by a copy of the opinion, notification, or advisory letter issued to the plan.

SEC. 8. SPECIAL RULES FOR MULTIPLE EMPLOYER PLANS

.01 The instructions contained in this section apply to applications filed for plans described in section 413(c) of the Code.

.02 An application filed for a multiple employer plan must include a completed Form 5300 for the plan, filed on behalf of one employer, and a separate Form 5300 completed through line 12 for each other employer maintaining the plan. In addition, a completed Form 5302 must be filed for each employer maintaining the plan.

.03 Certain multiple employer plans have in the past received Service approval as M&P plans. These plans may continue to use an adoption agreement format if the application includes a completed adoption agreement for each employer maintaining the plan. Regardless of whether an adoption agreement format continues to be used for the plan, the rules of section 1.414(l)-1 of the regulations apply in determining whether the plan is a single plan for which only one determination letter will be issued and which requires only one user fee.

.04 The complete application, including all Forms 5300 and 5302 (and, if applicable, adoption agreements) for employers maintaining the plan as of the date of the application, must be filed as one package submission in the key district office where the association maintaining the plan, the trustees, or the plan administrators have their principal place of business. The application must be

directed to the attention of the key district office volume submitter coordinator.

.05 Multiple employer plan applicants that previously received Service approval as M&P plans and intend to continue use of an adoption agreement format are encouraged to request preliminary approval of the provisions of the plan, including the permitted adoption agreement elections, prior to making the submission described above. Preliminary approval may be requested by making a specific request to the volume submitter coordinator for the key district where the complete application will be filed, and attaching a copy of the plan and trust instrument, including a blank adoption agreement, and a copy of the latest opinion letter. The request should not include an application form or user fee. The key district will notify the applicant in writing if preliminary approval is granted, and the complete application may then be filed. Employers will not be entitled to rely on the preliminary approval as to the qualified status of the plan. If the applicant requests preliminary approval of the plan on or before the date that is 6 months after proposed regulations under section 401(a)(4) are published in the Federal Register, the Service will treat the TRA '86 section 401(b) remedial amendment period for the plan as not expiring earlier than the date that is twelve months after the date of the key district's preliminary approval.

.06 The Service will mail a copy of the determination letter issued for the plan to each employer maintaining the plan.

.07 If other employers become participating employers under the plan after a favorable determination letter has been issued, the employers may not continue to rely on the letter. However, an applicant may request a determination that the addition of new participating employers to the plan does not adversely affect qualified status by filing a completed Form 5300 for the plan, in the name of the controlling member on the Form 5300 previously filed, and a supplemental Form 5300 and Form 5302 (and, if applicable, adoption agreement) for each new participating employer. The Service will send copies of this determination letter only to the applicant and the new participating employers.

SEC. 9. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 88-42 is superseded for determination letter applications regarding plans described in section 4.02 of this revenue procedure that are filed under this revenue procedure on or after April 30, 1990.

.02 Section 4.02 of Rev. Proc. 80-30 is modified to provide that the special instructions in this revenue procedure will apply to any determination letter application filed with the Service on or after April 30, 1990.

.03 Sections 4.05 of Rev. Proc. 80-30, 4.04 of Rev. Proc. 85-43, and 12.02 of Rev. Proc. 89-13 are modified to provide that an employer that has adopted a master or prototype, regional prototype, or volume submitter plan and wants a determination as to its status as a member of an affiliated service group or as to whether it is the recipient of services of leased employees must file Form 5300, rather than Form 5307.

SEC. 10. EFFECTIVE DATE

This revenue procedure is effective on April 9, 1990.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 90-21

SECTION 1. PURPOSE

This revenue procedure modifies Rev. Proc. 89-9, 1989-1 C.B. 780, and Rev. Proc. 89-13, 1989-1 C.B. 801, regarding certain requirements for approval by the Service of master or prototype (M&P) pension, profit-sharing and annuity plans and regional prototype plans.

SEC. 2. OVERVIEW

.01 This revenue procedure modifies the Service's procedures concerning M&P and regional prototype plans in accordance with Announcement 89-79, 1989-25 I.R.B. 37. In that announcement, the Service indicated its intention to modify existing procedures to permit the use of alternative definitions of compensation in M&P and regional prototype plans, to expand the conditions under which employee contributions will be acceptable in these plans, and to establish procedures that will allow certain trade or professional organizations to sponsor M&P plans that are adopted by nonmember employers.

.02 This revenue procedure also makes other modifications to Rev. Proc. 89-9 and Rev. Proc. 89-13 that are in addition to those described in Announcement 89-79. These modifications relate to vesting, coverage, and minimum contribution requirements in standardized M&P and regional prototype plans, the adoption of M&P and regional prototype plans by governmental employers, and the Department of Labor (DOL) participant loan regulations. Finally, this revenue procedure extends the sponsor submission deadline that is a condition of continued and extended reliance for M&P and regional prototype plan adopters.

.03 Section 3 of this revenue procedure lists and provides a brief summary of other revenue procedures and announcements relating to the M&P and regional prototype programs. Section 4 contains a more detailed background explanation and description of the changes made by this revenue procedure. The actual modifications to Rev. Proc. 89-9 and Rev. Proc. 89-13 are in section 5.

SEC. 3. BACKGROUND

.01 Rev. Proc. 89-9 sets forth the general procedures of the Service on the issuance of opinion letters by the National Office regarding the acceptability of the form of M&P plans that have been amended for the Tax Reform Act of 1986 (TRA '86).

.02 Rev. Proc. 89-13 sets forth the general procedures of the Service on the issuance of notification letters regarding the acceptability of the form of regional prototype plans.

.03 Rev. Proc. 90-17, page 479, this Bulletin, sets forth the procedures on the payment of user fees for requests to the Service for rulings, opinion letters, notification letters, determination letters, and similar requests.

.04 Rev. Proc. 89-29, 1989-1 C.B. 893, provides final guidelines resulting from the Service's reconsideration of Rev. Proc. 75-49, 1975-2 C.B. 584, relating to the determination of whether the vesting schedule of an employee plan results in, or is likely

to result in, prohibited discrimination.

.05 Announcement 89-79, 1989-25 I.R.B. 37, announced the Service's intention to modify Rev. Proc. 89-9 and Rev. Proc. 89-13 regarding the ability of trade or professional organizations to sponsor M&P plans, the ability of prototype plans to permit employee contributions, and the ability of prototype plans to use alternative definitions of compensation.

.06 Announcement 89-118, 1989-39 I.R.B. 59, extends until March 31, 1990, the deadline by which M&P and regional prototype plans must be submitted to qualify for the interim, continued, or special extended reliance procedures under Rev. Proc. 89-9 and Rev. Proc. 89-13.

SEC. 4. EXPLANATION OF MODIFICATIONS

.01 *Purpose of this Section.* This section contains a general explanation and description of the principal modifications to Rev. Proc. 89-9 and Rev. Proc. 89-13 that are contained in this revenue procedure, and includes pertinent background information. The actual modifications to Rev. Proc. 89-9 and Rev. Proc. 89-13 are set forth in section 5.

.02 *Trade or Professional Organizations.*

(1) *Background.* Under Rev. Proc. 89-9, a sponsoring organization is defined to include a trade or professional organization that has characteristics similar to those described in section 1.501(c)(6)-1 of the regulations and that markets its plans only to its members in their capacity as adopting employers. Announcement 89-79 provided that the definition of sponsoring organization in Rev. Proc. 89-9 would be modified to allow trade or professional organizations exempt from federal taxation under section 501(c)(6) to sponsor a standardized defined contribution plan even if the plan is intended to be made available to member institutions for adoption by nonmember employers.

(2) *Description of modifications to Rev. Proc. 89-9.*

(a) The definition of sponsoring organization under Rev. Proc. 89-9 is modified consistent with the modifications discussed in Announcement 89-79. In addition, to ensure that the responsibilities imposed on sponsoring organizations and the protections and rights accorded adopting employers under Rev. Proc. 89-9 are not diminished by this modification, this revenue procedure requires that these plans must contain language setting out the duties and responsibilities of both the trade or professional organization and the member institutions that use the plan. Where a trade or professional organization sponsors a plan of a mass submitter, the additional language will be considered a minor modification of the mass submitter's plan as described in section 18.032 of Rev. Proc. 89-9. (See section 5.01 for the specific procedures that modify Rev. Proc. 89-9.)

(b) Rev. Proc. 89-9 is further modified to provide that a trade or professional organization that qualifies as a sponsoring organization under this modified definition must submit with its opinion letter application a user fee equal to the total fee that would apply if the plan were a mass submitter plan and all member organizations using the plan were identical adopters. Where a trade or professional organization sponsors a plan of a mass submitter, the required user fee equals the sum of (i) the fee payable for the sponsoring organization's minor modification of the mass submitter's plan, and (ii) the fee that would apply if each member using the plan were an identical adopter of the plan. (See section 5.02 for the specific procedures that modify Rev. Proc. 89-9.)

.03 *Definition of Replacement Plan.*

(1) *Background.* Rev. Proc. 89-9, as amended by Announcement 89-118, allows an employer that has adopted an M&P plan with a favorable TEFRA opinion letter to continue to rely on the favorable opinion or determination letter if the M&P plan's sponsoring organization submits a replacement plan to the Service by March 31, 1990. A trade or professional organization that received a favorable TEFRA opinion letter but that does not qualify as a sponsoring organization under Rev. Proc. 89-9, as modified by this revenue procedure, will not be able to provide continued or interim reliance under Rev. Proc. 89-9 to adopting employers.

(2) *Description of modifications to Rev. Proc. 89-9.* The definition of a replacement plan is modified in order to provide relief to employers that have adopted plans sponsored by trade or professional organizations that no longer qualify as sponsoring organizations. As modified, the term "replacement plan" includes a plan submitted by a sponsoring organization (within the meaning of Rev. Proc. 89-9, as modified by this procedure) that amends or replaces a trade or professional organization's plan that has received a favorable TEFRA opinion letter and has been made available for employer adoption by the sponsoring organization. Thus, an employer that adopts a TEFRA approved plan of a trade or professional organization that is no longer an eligible sponsor may receive continued or interim reliance provided the employer's adoption of the trade or professional organization plan occurs on or before the date described in section 5.04 and all the other conditions of section 13 of Rev. Proc. 89-9 are met. (If the trade or professional organization's plan is not properly replaced by the date described in section 5.04 employers that adopted the TEFRA approved plan will be entitled to continued or interim reliance if all the conditions under section 13.05 of Rev. Proc. 89-9 are met. See section 5.03 for the specific procedures that modify Rev. Proc. 89-9.)

.04 *Submission Date for M&P and Regional Prototype Plans.*

(1) *Background.* Under Rev. Proc. 89-9, as modified by Announcement 89-118, a sponsoring organization of an approved M&P plan must submit a replacement plan to the Service by March 31, 1990 in order to provide its adopting employers with continued or interim reliance. Under Rev. Proc. 89-13, as modified by Announcement 89-118, an employer that adopts a regional prototype plan that is submitted to the Service by March 31, 1990 may be entitled to extend the remedial amendment period for amending its plan to comply with TRA '86. In addition, both Rev. Proc. 89-9 and Rev. Proc. 89-13 provide a special extended reliance procedure which allows an employer to continue to rely on a favorable opinion, notification, or determina-

tion letter issued under these procedures until the last day of the last plan year commencing before January 1, 1995 if the plan is submitted to the Service by March 31, 1990.

(2) *Description of modifications to Rev. Proc. 89-9 and Rev. Proc. 89-13.* The March 31, 1990 deadline for submitting plans under Rev. Proc. 89-9 and Rev. Proc. 89-13 is extended until the date that is 90 days after the date proposed regulations under section 401(a)(4) are published in the Federal Register. (See section 5.04 for the specific procedures that modify Rev. Proc. 89-9 and Rev. Proc. 89-13.)

.05 *Governmental Plans.*

(1) *Background.* Section 9.0313 of Rev. Proc. 89-9 and section 5.02(12) of Rev. Proc. 89-13 provide that the Service will not issue opinion or notification letters for governmental plans described in section 414(d) of the Code. These sections are intended to preclude the issuance of opinion and notification letters for plans that do not meet the qualification requirements that apply to plans maintained by nongovernmental employers.

(2) *Description of modifications to Rev. Proc. 89-9 and Rev. Proc. 89-13.* Rev. Proc. 89-9 and Rev. Proc. 89-13 are modified to clarify that the Service will not issue an opinion or notification letter for an M&P or regional prototype plan that includes qualification provisions for governmental plans. This does not preclude governmental employers from adopting an M&P or regional prototype plan that satisfies the qualification requirements for nongovernmental plans. (See section 5.05 for the specific procedures that modify Rev. Proc. 89-9 and Rev. Proc. 89-13.)

.06 *Employee and Matching Contributions.*

(1) *Background.* Rev. Proc. 89-9 provides that the Service will not issue an opinion letter for a plan that permits contributions that are subject to the non-discrimination requirements of section 401(m) unless the plan includes a qualified cash or deferred arrangement (CODA) or the plan is a master plan that designates the sponsoring organization as plan administrator. Rev. Proc. 89-13 provides that the Service will not issue a notification letter for a regional prototype plan that permits contributions that are subject to the requirements of section 401(m) unless the plan includes a CODA.

(2) *Description of modifications to Rev. Proc. 89-9 and Rev. Proc. 89-13.* Announcement 89-79 indicated that Rev. Proc. 89-9 and Rev. Proc. 89-13 would be modified to provide that the Service will accept prototype plans that permit after- tax employee contributions if the basic plan document designates the sponsoring organization as plan administrator. Rev. Proc. 89-9 and Rev. Proc. 89-13 are modified to allow section 401(m) contributions in any M&P or regional prototype plan that, by its terms, meets either of the following two conditions. First, the plan may designate the sponsoring organization or the regional prototype sponsor as plan administrator. Second, the plan may obligate the sponsoring organization or the regional prototype sponsor to (a) maintain records that enable it to monitor each adopting employer's compliance with the requirements of section 401(m); (b) perform the section 401(m) actual contribution percentage test for adopting employers on an annual basis; and (c) notify adopting employers if they are required to correct excess aggregate contributions. (See section 5.06 for the specific procedures that modify Rev. Proc. 89-9 and Rev. Proc. 89-13.)

.07 *Definition of Compensation.*

(1) *Background.* Rev. Proc. 89-9 provides that the Service will not issue an opinion letter for an M&P plan that bases plan contributions or benefits on less than total compensation as defined in section 414(s) of the Code. Rev. Proc. 89-13 provides a similar rule for regional prototype plans.

(2) *Description of modifications to Rev. Proc. 89-9 and Rev. Proc. 89-13.* Announcement 89-79 provided that Rev. Proc. 89-9 and Rev. Proc. 89-13 would be modified to permit the use of alternative definitions of compensation in nonintegrated nonstandardized M&P and regional prototype plans. Rev. Proc. 89-9 and Rev. Proc. 89-13 are modified to be consistent with Announcement 89-79. (See section 5.07 for the specific procedures that modify Rev. Proc. 89-9 and Rev. Proc. 89-13.)

.08 *Vesting Schedules Under Standardized Plans.*

(1) *Background.* Rev. Proc. 89-9 and Rev. Proc. 89-13 provide that an employer that adopts a standardized M&P or regional prototype plan may generally rely directly on the opinion or notification letter without having to request a determination letter. These procedures require standardized plans to provide vesting at least as favorable for every year as the vesting required by section 416(b) for top-heavy plans (i.e., full vesting after 3 years, or 6-year graded vesting). However, Rev. Proc. 89-29 holds that, for plan years beginning after December 31, 1988, a plan that satisfies the minimum vesting standards of section 411(a)(2) as amended by TRA '86 (i.e., full vesting after 5 years or 7-year graded vesting) or, in the case of a top-heavy plan, the requirements of section 416(b), will be deemed to provide nondiscriminatory vesting for purposes of an advance determination letter.

(2) *Description of modifications to Rev. Proc. 89-9 and Rev. Proc. 89-13.* Rev. Proc. 89-9 and Rev. Proc. 89-13 are modified to eliminate the requirement that standardized plans provide top-heavy vesting at all times, regardless of whether the plan is top-heavy. Of course, a standardized plan (or a nonstandardized plan) may continue to provide top-heavy vesting at all times as this will always satisfy the minimum vesting standards of section 411(a). (See section 5.08 for the specific procedures that modify Rev. Proc. 89-9 and Rev. Proc. 89-13.)

.09 *Coverage Requirements Under Standardized Plans.*

(1) *Background.* A standardized plan must, by its terms, meet the coverage requirements of section 410. Thus, Rev. Proc. 89-9 and Rev. Proc. 89-13 require a standardized plan, by its terms, to benefit all employees except those that may be excluded under section 410(a)(1) or (b)(3). An employee is treated as benefiting for purposes of the coverage requirements only if the employee actually accrues a benefit under the plan. A participant will not be treated as benefiting if the participant does not accrue a benefit because of a

requirement to be employed on the last day of the plan year or to complete a specified number of hours of service. Therefore, a standardized plan may not require a participant to be employed on the last day of the plan year or to complete a specified number of hours of service in order to receive an accrual or allocation, except as permitted under section 1.410(b)-3(c) of the proposed regulations. Section 1.410(b)-3(c) of the proposed regulations contains a special minimum service accrual rule which provides that a participant may be excluded in determining whether a plan meets the coverage requirements if the participant both (a) fails to accrue a benefit or receive an allocation solely because of a minimum service or last day of the plan year requirement and (b) terminates employment with no more than 500 hours of service.

(2) *Description of modifications to Rev. Proc. 89-9 and Rev. Proc. 89-13.* Rev. Proc. 89-9 and Rev. Proc. 89-13 are modified to clarify that a standardized plan may provide that an employee who is eligible to participate under the plan will not receive an allocation or accrual for a plan year if the employee terminates employment during the plan year with no more than 500 hours of service and is not an active employee as of the last day of the plan year. (See section 5.09 for the specific procedures that modify Rev. Proc. 89-9 and Rev. Proc. 89-13.)

.10 *Required Contributions Under a Standardized CODA.*

(1) *Background* Section 8.0116 of Rev. Proc. 89-9 and section 7.01(16) of Rev. Proc. 89-13 provide that a CODA must contain provisions that satisfy the top-heavy requirements of section 416 of the Code. These sections also provide that for plan years beginning on or after January 1, 1989, plans may not use elective deferrals or matching contributions to satisfy the minimum contribution requirements of section 416. Section 8.031 of Rev. Proc. 89-9 and section 7.03(1) of Rev. Proc. 89-13 provide that a standardized plan that includes a CODA must provide a minimum qualified nonelective contribution of 3% of compensation.

(2) *Description of modifications to Rev. Proc. 89-9 and Rev. Proc. 89-13.* Rev. Proc. 89-9 and Rev. Proc. 89-13 are modified to clarify that the requirement that a standardized CODA provide a minimum qualified nonelective contribution of 3% of compensation only applies if the plan is top-heavy and does not otherwise satisfy the minimum contribution requirements of section 416. Thus, if the plan is top-heavy and does not meet the minimum contribution requirements through employer nonelective contributions under the plan, or through contributions or benefits under another plan, then the plan must provide a qualified nonelective contribution to satisfy the requirements of section 416. Elective contributions may not be used to satisfy the top-heavy minimum contribution requirements. Matching contributions also may not be used to satisfy the top- heavy minimum contribution requirements in M&P and regional prototype plans. (See section 5.10 for the specific procedures that modify Rev. Proc. 89-9 and Rev. Proc. 89-13.)

.11 *Participant Loans.*

(1) *Background.* Final regulations under section 408(b)(1) of ERISA, which were published by DOL in the Federal Register on July 20, 1989 (54 FR 39520), require a participant loan program that is contained in a plan or in a written document forming part of a plan to include, at a minimum, certain information described in section 2550.408b-1(d)(2) of these regulations. This requirement applies where a participant loan is granted or renewed by a plan on or after the last day of the first plan year beginning on or after January 1, 1989.

(2) *Mechanism for complying with the participant loan regulations.* This revenue procedure provides a mechanism for M&P and regional prototype plans that provide for participant loans or allow the adopting employer to elect to provide for loans to comply with the requirements of the final DOL regulations under section 408(b)(1) of ERISA. Under this mechanism, M&P and regional prototype plans are permitted to adopt procedures that will comply with the requirements of the DOL regulations without either affecting the M&P or regional prototype status of their plan or requiring resubmission of the plan to the Service. (See section 5.11.)

SEC. 5. MODIFICATIONS TO REV. PROC. 89-9 AND REV. PROC. 89-13

.01 *Trade or Professional Organizations.*

(1) The definition of "sponsoring organization" in section 3.07 of Rev. Proc. 89-9 is modified to add to the categories therein a trade or professional organization exempt from federal income taxation under section 501(c)(6) of the Code that furnishes to those of its members that independently qualify as sponsoring organizations a standardized defined contribution plan intended for adoption by nonmember employers.

(2) Sections 5.08, 10.08, 13, 14, 15, and 16 of Rev. Proc. 89-9 are modified to provide that the following additional requirements apply to a plan described in the preceding paragraph:

(a) The adoption agreement for the plan must contain, in lieu of the statement described in the last sentence of section 5.08 of Rev. Proc. 89-9, a statement that any member of the trade or professional organization that offers the plan to employers for adoption will inform its adopting employers of any amendments made to the plan or of the discontinuance or abandonment of the plan.

(b) The members of the trade or professional organization that make the plan available to adopting employers must provide their adopting employers with a copy of the plan, copies of any subsequent amendments, and the most recently issued Internal Revenue Service opinion letter.

(c) If the opinion letter issued for the plan is revoked, the trade or professional organization must notify each member that is using its plan of the revocation. Those members must then notify their adopting employers that the opinion letter has been revoked.

(d) If the trade or professional organization withdraws its request for an opinion letter, the organization must notify each member that is using its plan that the request has been withdrawn. Those members must then notify their adopting employers that the request has been withdrawn. All

adopting employers will be deemed to have individually designed plans to which Rev. Proc. 80-30 applies.

(e) If the trade or professional organization abandons its plan, the organization must notify each member that is using its plan that the form of the plan has been terminated. Those members must then provide their adopting employers with the information required in the first sentence of section 16.02 of Rev. Proc. 89-9. After informing its members of the abandonment of the plan, the trade or professional should notify the National Office in accordance with subsection 16.01 of Rev. Proc. 89-9.

(3) Section 5 of Rev. Proc. 89-9 is modified to provide that a master or prototype plan described in section 5.01 of this revenue procedure must set forth the respective responsibilities of the sponsoring organization and the members making the plan available to adopting employers regarding the requirements of sections 5, 10, 13, 14, 15, and 16 of Rev. Proc. 89-9, as modified herein.

(4) Sections 6.04 and 12 of Rev. Proc. 89-9 are modified to provide that a master or prototype plan described in section 5.01 of this revenue procedure may be adopted by an employer that is not a member of the trade or professional organization and will not be considered an individually designed plan.

(5) Section 10 of Rev. Proc. 89-9 is modified to provide that a trade or professional organization that sponsors a plan described in section 5.01 of this revenue procedure must maintain a list of all members that make the plan available to adopting employers, including the specific plans each member is using. Section 10 of Rev. Proc. 89-9 is also modified to provide that the Service reserves the right to request this list at any time to verify that the trade or professional organization is complying with the requirements of Rev. Proc. 89-9 as modified by this revenue procedure.

.02 *User Fees.*

(1) Section 10.02 of Rev. Proc. 89-9 is modified to provide that the user fee for a plan described in section 5.01 of this revenue procedure will be determined under paragraphs (2) through (4), below.

(2) Generally, the user fee for a plan described in section 5.01 of this revenue procedure will be determined under Rev. Proc. 90-17 as if the plan were a mass submitter plan and as if each member using the plan were an identical adopter of the plan. Where the trade or professional organization sponsors a plan of a mass submitter, the user fee will be the sum of (a) the fee determined under Rev. Proc. 90-17 for a sponsoring organization's minor modification of a mass submitter's plan, and (b) the fee that would be required by Rev. Proc. 90-17 if each member using the plan were an identical adopter of a mass submitter's plan.

(3) If at the time the trade or professional organization initially requests an opinion letter under this procedure, it pays user fees on behalf of all its members based on the assumption that each member is using each adoption agreement under the plan (and certifies to the Service that it has done so), then no additional user fees will be required before the plan is next amended and entities that become members of the trade or professional organization in the interim period will be able to use the plan without the payment of an additional user fee. The Service reserves the right to request from the trade or professional organization membership lists as of the date of the application and as of any later date to ensure that the proper user fees have been submitted.

(4) Upon its initial application for an opinion letter, the trade or professional organization may pay a user fee on behalf of only those members using the plan. If the initial user fee is calculated on less than the full membership of the trade or professional organization, then the payment must be accompanied by a list showing those members for whom payment is being submitted, and identifying the adoption agreements being used by each member. Other members of the organization, including new members, will not be entitled to use the plan until an updated list and additional user fees are submitted on behalf of these members.

.03 *Definition of Replacement Plan.* The definition of replacement plan under section 3.10 of Rev. Proc. 89-9 is modified to include a plan that restates or amends a TEFRA approved plan (or plans) of a trade or professional organization and is submitted by a sponsoring organization that offered the TEFRA approved plan to adopting employers.

.04 *Submission Date for M&P and Regional Prototype Plans.* Rev. Proc. 89-9 and Rev. Proc. 89-13, as amended by Announcement 89-118, are modified to substitute "the date that is 90 days after the date proposed regulations under section 401(a)(4) are published in the Federal Register" for "March 31, 1990" each place the latter date appears therein.

.05 *Governmental Plans.* Sections 9.0313 of Rev. Proc. 89-9 and 5.02(12) of Rev. Proc. 89-13 are modified to provide that the Service will not issue opinion or notification letters for M&P or regional prototype plans which include qualification requirements for governmental plans described in section 414(d) of the Code.

.06 *Employee and Matching Contributions.* Sections 4.063 and 9.0315 of Rev. Proc. 89-9 and sections 3.05(3) and 5.02(14) of Rev. Proc. 89-13 are modified to provide that the Service will also issue an opinion or notification letter, as applicable, for any M&P or regional prototype plan that provides for contributions that are subject to the special nondiscrimination requirements of section 401(m) if the plan either designates the sponsoring organization (or regional prototype sponsor) as plan administrator or obligates the sponsoring organization (or regional prototype sponsor) to (1) maintain records that enable it to monitor adopting employer's compliance with the requirements of section 401(m); (2) perform the section 401(m) actual contribution percentage test for adopting employers on an annual basis; and (3) notify adopting employers if they are required to correct excess aggregate contributions.

.07 *Definition of Compensation.* Sections 9.0311 and 9.0312 of Rev. Proc. 89-9 and sections 5.02(10) and 5.02(11) of Rev. Proc. 89-13 are modified to provide that only standardized or integrated plans (other than any CODA portion of these plans) must allocate contributions or forfeitures or provide benefits on the basis of total compensation within the meaning of section 414(s).

.08 *Vesting Schedules Under Standardized Plans.* Sections 3.08 of Rev. Proc. 89-9 and 4.11 of Rev. Proc. 89-13 are modified to delete the requirement that a standardized plan provide vesting schedules that are at least as favorable as those required by section 416(b)(1)(A) or (B).

.09 *Coverage Requirements Under Standardized Plans.*

(1) Sections 3.08 of Rev. Proc. 89-9 and section 4.11 of Rev. Proc. 89-13 are modified to allow a standardized plan to impose certain conditions on the accrual or allocation of benefits as set forth below.

(2) For plan years beginning on or after January 1, 1990, a standardized plan generally may not deny an accrual or allocation to an employee eligible to participate merely because the employee is not an active employee on the last day of the plan year or has failed to complete a specified number of hours of service during the year. However, the plan may deny an allocation or accrual to an employee who is eligible to participate if the employee terminates service during the plan year with not more than 500 hours of service and is not an active employee on the last day of the plan year.

(3) For plan years commencing before January 1, 1990, a standardized defined contribution plan may contain a requirement that an employee be an active employee on the last day of the plan year, regardless of the number of hours of service earned during the year, in order to receive an allocation, and any standardized plan may contain a requirement that an employee must complete a specified number of hours of service during the plan year in order to receive an allocation or accrual (other than allocations required by section 416).

.10 *Required Contributions Under a Standardized CODA.* Sections 8.031 of Rev. Proc. 89-9 and 7.03(1) of Rev. Proc. 89-13 are modified to provide that a standardized plan that includes a CODA must provide nonkey employees a minimum qualified nonelective contribution that is not less than the top-heavy minimum contribution required under section 416 if the plan is top-heavy and either does not meet the minimum contribution requirements through employer nonelective contributions under the plan or does not provide that the minimum top-heavy requirements will be met through contributions or benefits under another plan. Elective contributions may not be used to satisfy the top-heavy minimum contribution requirements. Matching contributions also may not be used to satisfy the top-heavy minimum contribution requirements under an M&P or regional prototype plan.

.11 *Mechanism for Complying with the Participant Loan Regulations.*

(1) In the case of an M&P plan that has a favorable TEFRA opinion letter and that provides for participant loans, sponsoring organizations and adopting employers may adopt procedures that comply with the requirements of the final DOL regulations in a written document that is separate from the basic plan document, trust, and adoption agreement (e.g., in a summary plan description or a separate procedural document). The adoption of procedures outside of the plan document that are intended to comply with the final DOL regulations under section 408(b)(1) of ERISA will not cause an M&P plan to be considered an individually designed plan nor require the resubmission of the plan to the Service.

(2) In the case of M&P plans that do not have a favorable TEFRA opinion letter (i.e. replacement plans or new plans) and regional prototype plans, procedures that comply with the final DOL regulations may be adopted in the plan or in a separate written document.

(3) The Service will not review loan program procedures (whether in the plan or in a separate written document) to determine whether they comply with the requirements of the final DOL regulations. Also, any opinion or notification letters issued for an M&P or regional prototype plan will not consider whether loan program procedures may, in the operation of the plan, have an adverse effect on the qualified status of the plan. However, the loan program procedures under the plan may not be inconsistent with the qualification requirements of section 401(a).

SEC. 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 89-9 and Rev. Proc. 89-13 are modified.

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, Section 280F; 1.280F-2T, 1.280F-7T.)

Rev. Proc. 90-22

SECTION 1. PURPOSE

This revenue procedure provides owners and lessees of passenger automobiles with tables detailing the limitations on depreciation deductions for automobiles first placed in service during calendar year 1990 and the amounts to be included in income for automobiles first leased during calendar year 1990. Each table reflects the automobile price inflation adjustments required by section 280F(d)(7) of the Internal Revenue Code.

SEC. 2. BACKGROUND

For owners of automobiles, section 280F(a) of the Code imposes dollar limitations on the depreciation deduction for both the year that the automobile is placed in service and each succeeding year. Section 280F(d)(7) requires the amounts allowable as depreciation deductions to be increased by a price inflation adjustment amount for passenger automobiles placed in service after calendar year 1988.

For leased automobiles, section 280F(c) of the Code requires a reduction in the deduction allowed to the lessee of the automobile. The reduction must be substantially equivalent to the limitations on the depreciation deductions imposed on owners of automobiles. Under section 1.280F-7T(a) of the temporary Income Tax Regulations, this reduction requires the lessees to include in gross income an inclusion amount determined by applying a formula to the amount obtained from a table. The table shows inclusion amounts for a range of fair market values for each tax year after the automobile is first leased.

SEC. 3. SCOPE AND OBJECTIVE

01. The limitations on depreciation deductions in section 4.02 of this revenue procedure apply to automobiles (other than leased automobiles) that are placed in service in calendar year 1990, and continue to apply for each tax year that the automobile remains in service.

02. The table in section 4.03 of this revenue procedure applies to leased

automobiles for which the lease term begins in calendar year 1990. Lessees of such automobiles must use this table to determine the inclusion amount for each tax year during which the automobile is leased. See sections 1.280F5T(d), 1.280F-5T(e) and 1.280F-7T(a) of the temporary regulations, and Rev. Proc. 89-64, 1989-2 C.B. 783, to determine inclusion amounts for automobiles first leased before January 1, 1990.

SEC. 4. APPLICATION

01. A taxpayer placing an automobile in service for the first time during calendar year 1990 is limited to the depreciation deduction shown in Table 1 of section 4.02(2) for 1990 and succeeding years. A taxpayer first leasing an automobile in calendar year 1990 must use Table 2 in section 4.03 to determine the inclusion amount that is added to gross income for 1990 and succeeding years. Otherwise, the procedures of section 1.280F-7T(a) of the temporary regulations must be followed.

02. *Limitations on Depreciation Deductions for Certain Automobiles.*

(1) *Amount of the Inflation Adjustment.* Under section 280F(d)(7)-(B)(i) of the Code, the automobile price inflation adjustment for any calendar year is the percentage (if any) by which the CPI automobile component for October of the preceding calendar year exceeds the CPI automobile component for October 1987. The term "CPI automobile component" is defined in section 280F(d)(7)(B)(ii) as the "automobile component" of the Consumer Price Index for all Urban Consumers published by the Department of Labor (the CPI). The new car component of the CPI was 115.2 for October 1987 and 118.6 for October 1989. The October 1989 index exceeded the October 1987 index by 3.4. The Internal Revenue Service has, therefore, determined that the automobile price inflation adjustment for 1990 is 2.95 percent (3.4/115.2 × 100%). This adjustment is applicable to all cars that are first placed in service in calendar year 1990. The dollar limitations in section 280F(a) must therefore be multiplied by a factor of .0295, and the resulting increases, after rounding to the nearest $100, are added to the 1988 limitations to give the depreciation limitations for 1990.

(2) *Amount of the Limitation.* For automobiles placed in service in calendar year 1990, Table 1 contains the dollar amount of the depreciation limitations for each tax year.

REV. PROC. 90-22 TABLE 1

Depreciation Limitations for Automobiles First Placed in Service in 1990

Tax Year	*Amount*
1st Tax Year (1990)	$2,660
2nd Tax Year (1991)	$4,200
3rd Tax Year (1992)	$2,550
Each Succeeding Year	$1,475

03. *Inclusions in Income of Lessees of Automobiles.*

The inclusion amounts for automobiles first leased in calendar year 1990 are calculated under the procedures described in section 1.280F-7T(a) of the temporary regulations. Table 2 of this revenue procedure is the applicable table to be used in applying those procedures.

REV. PROC. 90-22 TABLE 2

DOLLAR AMOUNTS FOR AUTOMOBILES WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 1990

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st (1990)	2nd (1991)	3rd (1992)	4th (1993)	5th or Later
$ 12,800 ---	$ 13,100 ---	$0	$0	$0	$1	$2
13,100 ---	13,400 ---	0	2	3	5	9
13,400 ---	13,700 ---	3	11	15	21	26
13,700 ---	14,000 ---	8	19	29	37	45
14,000 ---	14,300 ---	12	29	42	53	64
14,300 ---	14,600 ---	16	38	55	70	83
14,600 ---	14,900 ---	20	47	69	86	101
14,900 ---	15,200 ---	24	56	83	102	120
15,200 ---	15,500 ---	28	65	97	118	139
15,500 ---	15,800 ---	33	74	110	134	158
15,800 ---	16,100 ---	37	83	123	151	176
16,100 ---	16,400 ---	41	93	136	167	195
16,400 ---	16,700 ---	45	102	150	183	213
16,700 ---	17,000 ---	49	111	164	199	232
17,000 ---	17,500 ---	55	123	182	220	258
17,500 ---	18,000 ---	62	138	204	248	289
18,000 ---	18,500 ---	69	153	227	275	319
18,500 ---	19,000 ---	76	168	250	301	351
19,000 ---	19,500 ---	83	184	271	329	382

REV. PROC. 90-22 TABLE 2 (contd.)

DOLLAR AMOUNTS FOR AUTOMOBILES WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 1990

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st (1990)	2nd (1991)	3rd (1992)	4th (1993)	5th or Later
19,500 ---	20,000 ---	90	199	294	356	413
20,000 ---	20,500 ---	97	214	317	382	445
20,500 ---	21,000 ---	104	229	339	410	476
21,000 ---	21,500 ---	111	244	362	437	507
21,500 ---	22,000 ---	117	260	384	464	538
22,000 ---	23,000 ---	128	282	419	504	585
23,000 ---	24,000 ---	142	313	463	558	647
24,000 ---	25,000 ---	156	343	508	613	709
25,000 ---	26,000 ---	170	373	554	666	772
26,000 ---	27,000 ---	183	404	599	720	834
27,000 ---	28,000 ---	197	435	643	774	897
28,000 ---	29,000 ---	211	465	688	829	959
29,000 ---	30,000 ---	225	495	734	882	1,021
30,000 ---	31,000 ---	239	526	778	936	1,084
31,000 ---	32,000 ---	253	556	824	990	1,146
32,000 ---	33,000 ---	267	586	869	1,044	1,209
33,000 ---	34,000 ---	281	617	913	1,099	1,270
34,000 ---	35,000 ---	295	647	959	1,152	1,333
35,000 ---	36,000 ---	309	677	1,004	1,206	1,396
36,000 ---	37,000 ---	322	708	1,049	1,260	1,458
37,000 ---	38,000 ---	336	738	1,094	1,315	1,520
38,000 ---	39,000 ---	350	769	1,139	1,368	1,583
39,000 ---	40,000 ---	364	799	1,184	1,423	1,664
40,000 ---	41,000 ---	378	829	1,230	1,476	1,707
41,000 ---	42,000 ---	392	860	1,274	1,530	1,770
42,000 ---	43,000 ---	406	890	1,319	1,585	1,832
43,000 ---	44,000 ---	420	920	1,365	1,638	1,894
44,000 ---	45,000 ---	434	951	1,409	1,693	1,956
45,000 ---	46,000 ---	448	981	1,454	1,747	2,019
46,000 ---	47,000 ---	461	1,012	1,499	1,801	2,081
47,000 ---	48,000 ---	475	1,042	1,545	1,854	2,144
48,000 ---	49,000 ---	489	1,073	1,589	1,909	2,205
49,000 ---	50,000 ---	503	1,103	1,634	1,963	2,268
50,000 ---	51,000 ---	517	1,133	1,680	2,016	2,331
51,000 ---	52,000 ---	531	1,164	1,724	2,071	2,393
52,000 ---	53,000 ---	545	1,194	1,770	2,124	2,455
53,000 ---	54,000 ---	559	1,224	1,815	2,179	2,517
54,000 ---	55,000 ---	573	1,255	1,859	2,233	2,580
55,000 ---	56,000 ---	587	1,285	1,905	2,286	2,643
56,000 ---	57,000 ---	600	1,316	1,950	2,340	2,705
57,000 ---	58,000 ---	614	1,346	1,995	2,395	2,767
58,000 ---	59,000 ---	628	1,376	2,041	2,448	2,829
59,000 ---	60,000 ---	642	1,407	2,085	2,502	2,892
60,000 ---	62,000 ---	663	1,452	2,153	2,584	2,985
62,000 ---	64,000 ---	691	1,513	2,243	2,691	3,110
64,000 ---	66,000 ---	719	1,574	2,332	2,800	3,235
66,000 ---	68,000 ---	746	1,635	2,423	2,907	3,360
68,000 ---	70,000 ---	774	1,695	2,514	3,015	3,484
70,000 ---	72,000 ---	802	1,756	2,603	3,124	3,609
72,000 ---	74,000 ---	830	1,817	2,693	3,232	3,733
74,000 ---	76,000 ---	858	1,877	2,784	3,340	3,858
76,000 ---	78,000 ---	885	1,939	2,873	3,448	3,983
78,000 ---	80,000 ---	913	1,999	2,964	3,556	4,107

REV. PROC. 90-22 TABLE 2 (contd.)

DOLLAR AMOUNTS FOR AUTOMOBILES WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 1990

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st (1990)	2nd (1991)	3rd (1992)	4th (1993)	5th or Later
80,000 ---	85,000 ---	962	2,106	3,121	3,745	4,325
85,000 ---	90,000 ---	1,031	2,258	3,346	4,015	4,638
90,000 ---	95,000 ---	1,101	2,409	3,572	4,285	4,949
95,000 ---	100,000 ---	1,170	2,562	3,796	4,556	5,261
100,000 ---	110,000 ---	1,275	2,789	4,135	4,960	5,729
110,000 ---	120,000 ---	1,414	3,093	4,585	5,501	6,352
120,000 ---	130,000 ---	1,553	3,397	5,036	6,040	6,976
130,000 ---	140,000 ---	1,692	3,701	5,486	6,580	7,600
140,000 ---	150,000 ---	1,831	4,004	5,937	7,121	8,223
150,000 ---	160,000 ---	1,970	4,308	6,388	7,660	8,847
160,000 ---	170,000 ---	2,109	4,612	6,838	8,201	9,469
170,000 ---	180,000 ---	2,248	4,916	7,288	8,741	10,093
180,000 ---	190,000 ---	2,387	5,220	7,739	9,281	10,716
190,000 ---	200,000 ---	2,526	5,524	8,189	9,821	11,340
200,000 ---	210,000 ---	2,665	5,828	8,639	10,362	11,963
210,000 ---	220,000 ---	2,804	6,131	9,091	10,901	12,587
220,000 ---	230,000 ---	2,943	6,435	9,541	11,442	13,210
230,000 ---	240,000 ---	3,082	6,739	9,992	11,981	13,834
240,000 ---	250,000 ---	3,221	7,043	10,442	12,522	14,457

SEC. 5. EFFECTIVE DATE

This revenue procedure is effective for automobiles (other than leased automobiles) that are first placed in service during calendar year 1990 and to leased automobiles that are first leased during calendar year 1990.

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26 CFR 601.201: Rulings and determination letters
(Also Part I, Section 846.)

Rev. Proc. 90-23

SECTION 1. PURPOSE

This revenue procedure prescribes the manner in which taxpayers are to apply discount factors under section 846 of the Internal Revenue Code to unpaid losses as reported in the new configuration of lines of business that was adopted for the 1989 annual statement for fire and casualty insurance companies.

SEC. 2. BACKGROUND

.01 Section 846 of the Code provides rules for determining the discounted unpaid losses of property and casualty insurance companies. Discounted unpaid losses are a component of the losses incurred deduction of section 832(b)(5). Section 846(a) provides that discounted unpaid losses are separately computed for each accident year of each line of business by applying an annual interest rate determined under section 846(c) and the appropriate loss payment pattern to the amount of undiscounted unpaid losses (and unpaid loss adjustment expenses) measured as of the end of the tax year.

Section 846(d) of the Code directs the Secretary to determine a loss payment pattern for each line of business that is applicable to unpaid losses attributable to the accident year ending with a determination year (calendar year 1987 and each fifth calendar year thereafter) and to each of the four succeeding accident years.

Section 846(e) of the Code allows an eligible taxpayer to make an election in each determination year to use its own historical experience to determine a loss payment pattern for each accident year of each line of business.

Section 846(f) defines the term "line of business" as a category for the reporting of loss payment patterns on the annual statement for fire and casualty companies approved by the National Association of Insurance Commissioners (NAIC).

.02 Pursuant to the directives of section 846, the Internal Revenue Service annually publishes a series of discount factors for each line of business computed on the basis of an annually revised interest rate and loss payment patterns determined for each determination year. Discount factors applicable to unpaid losses attributable to 1987 and prior accident years are published in Rev. Rul. 87-34, 1987-1 C.B. 168. Discount factors applicable to 1988 accident year losses are published in Rev. Rul. 88-63, 1988-2 C.B. 130, and those applicable to 1989 accident year losses are published in Rev. Rul. 89-66A, 1989-1 C.B. 220.

.03 (1) The NAIC has adopted several changes to the reporting of unpaid loss experience on the annual statement. Beginning with the 1989 annual statement, unpaid losses

previously reported on Schedule O and Schedule P are reported on a revised Schedule P. In addition, the contents of several categories for the reporting of unpaid losses have been changed as described in sections 2.03(2) and 2.03(3) below.

(2) In two cases, unpaid losses that were reported in one line of business on annual statements for 1988 and prior years are now reported in several different lines: (a) Unpaid losses for the automobile liability line of business are now reported in two lines of business (private passenger auto liability/medical and commercial auto/truck liability/medical); and (b) Unpaid losses for the single line of business that included farmowners multiple peril, homeowners multiple peril, commercial multiple peril, ocean marine, aircraft (all perils), and boiler and machinery are now reported in three different lines (homeowners/farmowners, commercial multiple peril, and special liability).

(3) In three cases, unpaid losses that were reported in separate lines of business on annual statements for 1988 and prior years are now reported as one line: (a) Unpaid losses for the fire, allied lines, inland marine, earthquake, glass, and burglary and theft lines of business are now reported together in one line of business; (b) Unpaid losses for the fidelity, surety, and financial and mortgage guaranty lines of business are now reported in one line; and (c) Unpaid losses for the credit and credit accident and health lines of business are now reported in one line.

.04 In the 1987 determination year the Secretary determined a separate loss payment pattern for each line of business that, pursuant to section 846(d)(1), must be applied through the 1991 accident year. Because these patterns were computed on the basis of aggregate industry loss experience as reported on the 1985 annual statement, they do not correspond to the new configuration of lines of business for the reporting of unpaid losses on the 1989 annual statement. The statute provides for redetermination of payment patterns only once every five years. Thus, payment patterns cannot be redetermined until the 1992 determination year. Furthermore, published loss experience data necessary for computing payment patterns on the basis of the new configuration of lines of business does not currently exist.

.05 A taxpayer that in 1987 made a valid election under section 846(e) is required by that section to redetermine a separate loss payment pattern for each accident year of each line of business based on its own experience. These payment patterns are determined using unpaid loss experience as reported on the annual statement for the most recent year filed before the beginning of the accident year for which the payment pattern is determined. For example, payment patterns determined for the 1989 accident year are generally determined on the basis of 1987 annual statement information. Thus, these payment patterns do not correspond to the new configuration of categories for the reporting of unpaid losses on the 1989 annual statement.

.06 Once a series of discount factors has been applied to unpaid losses attributable to an accident year for a line of business, that series cannot be subsequently redetermined and must continue to be used from one tax year to the next to discount those losses. S. Rep. No. 99-313, 99th Cong., 2d Sess. 504 (1986), 1986-3 C.B. (Vol. 3) 504.

SEC. 3. SCOPE

This revenue procedure applies to any taxpayer that is required to discount its unpaid losses under section 846 and that files with insurance regulatory authorities of a state or territory the annual statement for fire and casualty companies approved by the NAIC. Thus, it generally applies to insurance companies taxable under section 831(a). This revenue procedure applies only to the annual statement changes described in section 2.03 of this revenue procedure and only for accident years before the first accident year for which discount factors are computed (either by the Internal Revenue Service or by an electing taxpayer) for the new configuration of lines of business that was adopted for the 1989 annual statement.

SEC. 4. PROCEDURE

.01 *Split lines.* If unpaid losses attributable to a single line of business for which the Internal Revenue Service (or a taxpayer electing to use its own experience under section 846(e) of the Code) has determined discount factors must subsequently be reported in two or more new lines on the annual statement, the discount factors determined for the original single line shall continue to be used to discount unpaid losses reported in each of the new lines.

.02 *Combined lines.* This section 4.02 provides taxpayers with two options for applying discount factors to unpaid losses that were reported in separate lines of business on annual statements for 1988 and prior years but are reported in one line beginning with the 1989 annual statement. A taxpayer using either option applies discount factors determined on the basis of the previously separate lines to unpaid losses reported on the new combined line of business. The options differ in the manner in which the unpaid losses reported in the new combined line are allocated among the previously separate lines for purposes of applying these discount factors.

No allocation must be made to the case of unpaid losses attributable to accident years for which discount factors are the same for each of the previously separate lines of business. Not allocating these losses does not violate the vintaging requirement described in section 2.06 of this revenue procedure. Discount factors published by the Secretary are the same for each of the previously separate lines of business in the case of all accident years other than the accident year ending with the year for which an annual statement is filed. Thus, for example, a taxpayer that applies these factors allocates among the previously separate lines of business only those unpaid losses reported for the new combined line of business that are attributable to the accident year ending with the annual statement year. No allocation is required for prior accident years. Similarly, a taxpayer that in 1987 made a valid election to use its own experience under section 846(e) must allocate among the previously separate lines of business only those unpaid losses reported for the new combined line of business that are attributable to an accident year for which the taxpayer computes different discount factors for the previously separate lines of business (see section 2.05 of this revenue procedure).

A taxpayer must elect one of the following allocation options by printing or typing "Rev. Proc. 90-23 Option One" or "Rev. Proc. 90-23 Option Two" at the top of Schedule F of its timely filed (including extensions) income tax return for the tax year ending with or within the 1989 calendar year and by using that option in discounting all unpaid losses described in section 2.03(3) of this revenue procedure on that return. For returns filed on or before May 16, 1990, the election may be made on an amended return filed on or before September 17, 1990. Once the election is made, it cannot be changed and remains in effect for all accident years to which this revenue procedure applies.

(1) *Option One: allocation based on taxpayer's actual experience reflected in records other than the annual statement.* For each accident year for which this revenue procedure requires an allocation, a taxpayer electing Option One allocates unpaid losses reported in the new combined line of business to each of the previously separate lines on the basis of its actual experience reflected in underlying books and records that segregate such unpaid losses in accordance with the previously separate lines of business. A taxpayer electing this option must maintain records necessary to support its allocation.

(2) *Option Two: allocation based on taxpayer's experience as reflected in prior annual statements.* For each accident year for which this revenue procedure requires an allocation, a taxpayer electing Option Two allocates unpaid losses reported in the new combined line of business to each of the previously separate lines of business in the same proportion that the total of losses for each such separate line reported on the annual statements of the taxpayer for 1986, 1987, and 1988, bear to the total of losses for all the previously separate lines of business reported on those annual statements.

This computation is made using only those unpaid losses attributable to the accident year shown in each of these annual statements (1986-1988) that are at the same stage of development as the unpaid losses attributable to the accident year of the new combined line of business that are being allocated. Thus, for example, in the case of a taxpayer applying discount factors published by the Internal Revenue Service, only unpaid loss amounts attributable to the current year (AY+0) from each of the prior annual statements are used, because for such taxpayers an allocation must be made only for AY+0.

.03 *Financial guaranty.* Unpaid losses attributable to the financial guaranty and related lines of business are discounted using the "Miscellaneous Casualty" discount factors published by the Secretary.

.04 *Examples.* The following examples illustrate the procedures of this revenue procedure. They do not display the level of mathematical accuracy that may be required of calculations made by a taxpayer for purposes of filing an income tax return:

Example (1). *X* Corporation, a calendar year taxpayer, is a property and casualty insurance company. *X* has not made an election under section 846(e) to use its own historical loss payment pattern. Since 1970, *X* has written policies in the automobile liability line of business. Beginning with the 1989 annual statement, *X* must report its unpaid losses for this line of business in two different categories: private passenger auto liability/medical and commercial auto/truck liability/medical.

See Table 1 for applicable discount factors and for the amounts of unpaid losses for the auto liability, commercial auto, and private passenger lines of business shown on *X*'s 1988 and 1989 annual statements.

Rev. Proc. 90-23 Table 1

Unpaid losses shown on *X*'s annual statement and applicable discount factors

Statement/Tax year	*Accident year*	
	1988	*1989*
1988 auto liability	1000 (88.4505%)	- - - -
1989 private passenger	500 (87.7895%)	600 (87.9621%)
commercial auto	400 (87.7895%)	600 (87.9621%)

For the 1988 tax year, *X* discounts 1988 accident year auto liability unpaid losses using the (AY+0) discount factor taken from the auto liability series of Rev. Rul. 88-63. For the 1989 tax year, *X* discounts 1988 accident year commercial auto and private passenger unpaid losses using the (AY+1) discount factor taken from the auto liability series of Rev. Rul. 88-63, and discounts 1989 losses for these lines using the (AY+0) discount factor taken from the auto liability series of Rev. Rul. 89-66A.

Example (2). *Y* Corporation, a calendar year taxpayer, is a property and casualty insurance company. *Y* has not made an election under section 846(e) to use its own historical loss payment pattern. Since 1980, *Y* has written policies in both the fidelity and the financial guaranty lines of business, and has written no policies for the surety line of business. Beginning in 1989, *Y* must report its unpaid losses for these lines of business in the same category on the annual statement. On its 1989 tax return, *Y* elects option one of section 4.02 of this revenue procedure.

See Table 2 for applicable discount factors and for the amounts of unpaid losses for the fidelity, financial guaranty, and new combined lines of business shown on *Y*'s 1988 and 1989 annual statements. *Y*'s records demonstrate that, of the $3400 of 1989 accident year unpaid losses shown on the 1989 statement for the new combined line, $2300 is attributable to the financial guaranty line and $1100 is attributable to the fidelity line.

Rev. Proc. 90-23 Table 2

Unpaid losses shown on *Y's* annual statement and applicable discount factors

Statement/Tax year	*Accident year*	
	1988	*1989*
1988		
fidelity	1000 (91.3524%)	- - - -
financial guaranty	2000 (94.7678%)	- - - -
surety	0 (91.5497%)	- - - -
1989		
new combined line	2500 (92.8522%)	3400
	fidelity	1100 (90.9630%)
as allocated by *Y*:	financial	2300 (94.5264%)
	surety	0 (91.1689%)

For the 1988 tax year, 1988 accident year unpaid losses are discounted using (AY+0) discount factors taken from the Fidelity and "Miscellaneous Casualty" series of Rev. Rul. 88-63. For the 1989 tax year, because the (AY+1) discount factor from both of these series is the same (92.8522%), *Y* is not required to allocate 1988 accident year losses in the new combined line to the previously separate lines. *Y* must allocate 1989 accident year losses in order to apply the differing (AY+0) discount factors for the previously separate lines taken from Rev. Rul. 89-66A.

Example (3). The facts are the same as in Example (2), except that on its 1989 tax return *Y* elects option two of section 4.02 of this revenue procedure. See Table 3 for the distribution of unpaid losses for the most recent accident year (AY+0) of the two previously separate lines of business as shown on *Y*'s 1986 through 1988 annual statements.

Rev. Proc. 90-23 Table 3

Distribution of unpaid losses attributable to AY+0 among old lines on *Y*'s annual statements for 1986 through 1988

	Statement year				
	1986	*1987*	*1988*		*Totals*
fidelity	1000	1200	1000	=	3200
financial guaranty	2000	2000	2000	=	6000
surety	0	0	0	=	0
					9,200

Thus, *Y* allocates its 1989 accident year unpaid losses reported on the 1989 annual statement for the new combined category based on a distribution of 34.78% (3200/9,200) to the fidelity line and 65.22% (6000/9,200) to the financial guaranty line. This results in 1182.52 (3400 x .3478) allocated to the fidelity line of business, 2217.48 (3400 x .6522) allocated to the financial guaranty line, and no amount allocated to the surety line.

SEC. 5. INQUIRIES

Inquiries concerning this revenue procedure should refer to its number and be addressed to the Office of the Assistant Chief Counsel (Financial Institutions and Products), Branch 4 (CC:FI&P:4), P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044.

SEC. 6. EFFECTIVE DATE

This revenue procedure is effective April 16, 1990, the date of its publication in the Internal Revenue Bulletin.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 25, 103, 143; 1.25-1T, 1.103-1, 6a.103A-2.)

Rev. Proc. 90-24

SECTION 1. PURPOSE

Section 3.05 of Rev. Proc. 89-59, 1989-2 C.B. 771, states which average area purchase price safe harbor limitations apply if a residence is in a metropolitan statistical area (MSA) or primary metropolitan statistical area (PMSA) that contains more than one state and that is listed in section 4 of that revenue procedure under a state that is different from the state in which the residence is located. That section does not make clear, however,

which safe harbor limitation applies if one category of residence (new or existing) is omitted because of insufficient data.

Section 4 of Rev. Proc. 89-59 includes a footnote that also does not indicate which state safe harbor limitation is to be used if one category of residence (new or existing) is omitted and the residence at issue is in an MSA or PMSA that contains more than one state and that is listed under a state that is different from the state in which the residence is actually located.

Rev. Proc. 89-59, Section 6.01 and 6.03, contains an error in the effective dates for the use of the new national average purchase prices and the average area purchase price safe harbor limitations.

SEC. 2 MODIFICATIONS OF REV. PROC. 89-59

.01 Section 3.05 of Rev. Proc. 89-59 is modified to read as follows:

> .05 If a residence is in an MSA or PMSA, the safe harbor limitation applicable to it is the limitation of that MSA or PMSA. In particular, if a residence is in an MSA or PMSA that contains more than one state and that is listed in section 4 under a state that is different from the state in which the residence is located, then the safe harbor limitation applicable to that residence is the limitation provided for the MSA or PMSA and not the limitation provided for all other areas in the state in which the residence is located. If sufficient data are not available for the applicable category of residence (new or existing) in the MSA or PMSA, however, then the safe harbor limitation for "all areas" or "all other areas" of the state in which the residence is actually located is used for the omitted category.

.02 All of the footnotes in section 4 of Rev. Proc. 89-59 are modified to read as follows:

"*Not available. The safe harbor limitation for all areas or all other areas of the state in which the residence is actually located may be used."

.03 Section 6.01 of Rev. Proc. 89-59 is modified to read as follows:

> .01 Issuers of qualified mortgage bonds and mortgage credit certificates must use the national and average area purchase price limitations contained in this revenue procedure when computing the housing cost/income ratio under section 143(f)(5) of the Code for commitments to provide financing that are made, or (if the purchase precedes the financing commitment) for residences that are purchased, in the period beginning on November 6, 1989, the date of publication of this revenue procedure in the Internal Revenue Bulletin, and ending on the date as of which such national and average area purchase prices are rendered obsolete by a new revenue procedure. If an issuer computes different average area purchase price limitations based on more accurate and comprehensive data, the issuer must use data from a 12-month period that does not begin earlier than December 1, 1987, or end later than November 30, 1989, for purposes of computing the housing cost/income ratio.

.04 Section 6.03 of Rev. Proc. 89-59 is modified to read as follows:

> .03 Issuers of qualified mortgage bonds and mortgage credit certificates may rely on the average area purchase price safe harbor limitations contained in this revenue procedure for the purpose of satisfying the purchase price requirement for commitments to provide financing that are made, or (if the purchase precedes the financing commitment) for residences that are purchased, in the period beginning on November 6, 1989, and ending on the date as of which such safe harbor limitations are rendered obsolete by a new revenue procedure.

.05 Section 6 is modified by adding subsection .07 that reads as follows:

> .07 Issuers of qualified mortgage bonds and mortgage credit certificates may continue to rely on an average area purchase price safe harbor limitation for an omitted category of residence (new or existing) based on a figure for "all areas" or "all other areas" of the state under which the MSA or PMSA is listed (even though the residence is not actually located in that state) for commitments to provide financing that are made, or (if the purchase precedes the financing commitment) for residences that are purchased before May 1, 1990.

SEC. 3. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 89-59 is modified. Section 3.03 of Rev. Proc. 89-32, 1989-1 C.B. 904, is obsolete.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 25, 103, 143; 1.25-1T, 1.103-1, 6a.103A-2.)

Rev. Proc. 90-25

SECTION 1. PURPOSE

This revenue procedure provides guidance concerning the national and area median gross income figures that are to be used by issuers of qualified mortgage bonds, as defined in section 143(a) of the Internal Revenue Code, and issuers of mortgage credit certificates, as defined in section 25(c), in computing the housing cost/income ratio described in section 143(f)(5).

SEC. 2. BACKGROUND

.01 Bonds issued by a state or local government to provide financing for owner-occupied residences must satisfy the requirements under section 143(a)(2) of the Code if the bonds are to be classified as "qualified mortgage bonds." The interest on qualified mortgage bonds is excludable from gross income under section 103(a) if certain additional requirements are satisfied. A state or local government may elect to exchange all or part of its qualified mortgage bond authority for authority to issue mortgage credit certificates. Recipients of mortgage credit certificates issued by a state or local government are allowed a credit against federal income tax for a portion of the interest paid or accrued on indebtedness used to finance owner-occupied residences provided that the income requirements of section 25 are satisfied. The income requirements that are imposed

on the users of proceeds of qualified mortgage bonds are identical to those imposed on the recipients of mortgage credit certificates. Sections 143(f) and 25(c)(2)(A)(iii)(IV).

.02 Generally, under sections 143(f) and 25(c)(2)(A)(iii)(IV) of the Code, the income requirements are met if all owner financing under a qualified mortgage bond and all certified indebtedness amounts under a mortgage credit certificate program are provided to mortgagors whose family income is 115 percent or less of the applicable median family income. The income limitation is reduced to 100 percent if there are fewer than three members in the mortgagor's family.

.03 Section 143(f)(5) of the Code provides, however, that the income requirement in certain statistical areas is adjusted based on the relation of housing costs to income. A statistical area is a "high housing cost area" if its housing cost/income ratio is greater than 1.2. The housing cost/income ratio is determined by dividing (a) the applicable housing price ratio by (b) the ratio that the area median gross income bears to the median gross income for the United States. The applicable housing price ratio is the new housing price ratio (new housing average area purchase price divided by the new housing average purchase price for the United States) or the existing housing price ratio (existing housing average area purchase price divided by existing housing average price for the United States), whichever results in the housing cost/income ratio being closer to 1. This income adjustment applies only to bonds issued and nonissued bond amounts elected after December 31, 1988.

.04 The Department of Housing and Urban Development (HUD) has computed the median gross income for the United States, the states, statistical areas within the states, and the District of Columbia for the fiscal year ending September 30, 1990. This income information was released to the HUD regional offices on February 1, 1990. The most recent national average purchase prices and average area purchase price safe harbor limitations were published in Rev. Proc. 89-59, 1989-2 C.B. 771, Rev. Proc. 89-59 was modified by Rev. Proc. 90-24, page 510, this Bulletin.

SEC. 3. APPLICATION

.01 When computing the housing cost/income ratio under section 143(f)(5) of the Code, issuers of qualified mortgage bonds and mortgage credit certificates must use as the median gross income for the United States a figure of $35,700 (estimated for the fiscal year ending September 30, 1990).

.02 When computing the housing cost/income ratio under section 143(f)(5) of the Code, issuers of qualified mortgage bonds and mortgage credit certificates must use the appropriate area median gross income for the fiscal year ending September 30, 1990, referred to in section 2.04 of this revenue procedure.

SEC. 4. EFFECTIVE DATES

.01 Except as provided in section 4.02, issuers of qualified mortgage bonds and mortgage credit certificates must use the national median gross income and area median gross income referred to in section 3 of this revenue procedure for purposes of computing the housing cost/income ratio under section 143(f)(5) of the Code for commitments to provide financing that are made, or (if the purchase of the residence precedes the financing commitment) for residences that are purchased, in the period beginning on February 1, 1990, the date HUD released the income figures, and ending on the date as of which these national and area median gross income figures are rendered obsolete by a new revenue procedure.

.02 Issuers of qualified mortgage bonds or mortgage credit certificates may continue to rely on the national and area median gross incomes estimated for the fiscal year ending September 30, 1989, and described in Rev. Proc. 89-32, 1989-1 C.B. 904, for (1) commitments to provide financing for mortgages with respect to bonds originally sold not later than May 30, 1990, 30 days after the date of publication of this revenue procedure in the Internal Revenue Bulletin, and (2) commitments to issue mortgage credit certificates with respect to nonissued bond amounts elected not later than May 30, 1990. The preceding sentence applies only if the commitments described in (1) and (2) are made not later than July 30, 1990, 91 days after publication of this revenue procedure in the Bulletin.

.03 The Service anticipates that when the national and area median gross income figures described in section 3 of this revenue procedure are rendered obsolete by the publication of a new revenue procedure, issuers of qualified mortgage bonds and mortgage credit certificates will be permitted to continue to use the income figures for commitments to provide financing that are made or (if the purchase of the residence precedes the financing commitment) for residences that are purchased, with respect to bonds originally sold and nonissued bond amounts elected not later than 30 days after the date of publication of the new revenue procedure in the Internal Revenue Bulletin if the commitments or purchases are made not later than 90 days after publication of the new revenue procedure in the Bulletin.

SEC. 5. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 89-32 is obsolete except as provided in section 4.02 of this revenue procedure.

.02 This revenue procedure does not affect the effective date provisions of Rev. Rul. 86-124, 1986-2 C.B. 27. Those effective date provisions remain operative at least until the Service publishes a new revenue ruling that conforms the approach to effective dates for the use of income data to the general approach taken in this revenue procedure.

.03 Announcement 89-73, 1989-24 I.R.B. 79, is superseded.

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.

Rev. Proc. 90-26

SECTION 1. PURPOSE

This revenue procedure provides guidance with respect to the required taxable year of certain foreign corporations for U.S. tax purposes under section 898(a) of the Internal Revenue Code and the election set forth in section 898(c)(1)(B) of the Code. It also provides guidance for foreign personal holding companies with respect to the designation of certain dividends paid as being taken into account under section 563(c).

SEC. 2. BACKGROUND

.01 Section 7401(a) of the Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, 103 Stat. 2106 (December 19, 1989) (The "Act"), added section 898 to the Code. Section 898 generally requires the taxable year of "specified foreign corporations" that are controlled foreign corporations or foreign personal holding companies to conform (for U.S. tax purposes) to the taxable year of their majority United States shareholder, as defined in section 898(c)(1)(C), for taxable years of such foreign corporations which begin after July 10, 1989. Section 898(c)(1)(B) permits a specified foreign corporation which is a controlled foreign corporation to elect a taxable year beginning one month earlier than the taxable year of its majority U.S. shareholder. Under section 898(c)(2), foreign personal holding companies that are not also controlled foreign corporations may not make the election provided by section 898(c)(1)(B). Accordingly, such foreign personal holding companies must follow section 3.01 of this revenue procedure and may not follow section 3.02 of this revenue procedure.

.02 Section 7401(b)(1) of the Act amended section 563 of the Code by adding a new subsection (c) which generally requires that in determining the dividends paid deduction for purposes of the foreign personal holding company provisions of the Code, a dividend paid after the close of any taxable year, and on or before the 15th day of the 3rd month following the close of such taxable year, will be considered as paid during such taxable year to the extent the foreign personal holding company designates the dividend as being taken into account under section 563(c). The amount allowed as a deduction by reason of the application of section 563(c) cannot exceed the undistributed foreign personal holding company income of the corporation for the taxable year computed without regard to section 563(c).

SEC. 3. CHANGES IN THE TAXABLE YEAR OF SPECIFIED FOREIGN CORPORATIONS AND THE PROCEDURE FOR ELECTION UNDER SECTION 898(c)(1)(B) OF THE CODE

.01 Specified foreign corporations described in section 898(b) of the Code are required to conform their taxable year to that of their majority U.S. shareholder. If no election under section 898(c)(1)(B) is being made for a specified foreign corporation, but the corporation is changing its first taxable year beginning after July 10, 1989, to conform to the taxable year of its majority U.S. shareholder, then the words "Change in Taxable Year—No Section 898(c)(1)(B) Election" must appear on Form 5471 and, if applicable, Form 1120F, with respect to the specified foreign corporation.

.02 The election under section 898(c)(1)(B) of the Code may be made for a specified foreign corporation which is a controlled foreign corporation for its first taxable year beginning after July 10, 1989, by indicating on Form 5471 and, if applicable, Form 1120F, that the taxable year shown on the form with respect to the controlled foreign corporation was determined in accordance with section 898(c)(1)(B). The following words must be used:

(1) if the election involves a change in the taxable year of the controlled foreign corporation, the words "Section 898(c)(1)(B) Election—Change in Taxable Year" must appear on the form; and

(2) if the election does not involve a change in the taxable year of the controlled foreign corporation, the words "Section 898(c)(1)(B) Election" must appear on the form.

.03 Any of the words required under section 3.01 or 3.02 of this revenue procedure to appear on Form 5471 and, if applicable, Form 1120F, must be placed in the upper left hand corner of the first page of the form. If a specified foreign corporation is not required to change its taxable year under section 3.01 of this revenue procedure or if a specified foreign corporation which is a controlled foreign corporation does not make the election described in section 3.02 of this revenue procedure, then no notation concerning this fact need appear on Form 5471 and, if applicable, Form 1120F.

.04 Section 7401(d)(2)(B) of the Act provides that if any foreign corporation is required by section 898 of the Code to change its taxable year for its first taxable year beginning after July 10, 1989, then the change will be treated as having been made with the consent of the Internal Revenue Service. In this connection, the changes in taxable year described in sections 3.01 and 3.02(1) of this revenue procedure constitute changes required under section 898 for which the consent of the Internal Revenue Service is granted under section 7401(d)(2)(B) of the Act. The consent of the Internal Revenue Service is not required for the election described in section 3.02(2) or in the circumstances described in the second sentence of section 3.03 of this revenue procedure.

.05 Guidance concerning the need to obtain the consent of the Internal Revenue Service for changes in taxable years under section 898 of the Code, including changes in connection with an election under section 898(c)(1)(B), for years other than the first taxable year of the specified foreign corporation beginning after July 10, 1989, will be provided in a subsequent administrative pronouncement or regulations, as will guidance concerning other issues raised by section 898.

SEC. 4. PROCEDURE FOR DESIGNATION OF A DIVIDEND AS BEING TAKEN INTO ACCOUNT UNDER SECTION 563(c) OF THE CODE

A foreign personal holding company may designate a dividend paid after the close of any taxable year beginning after July 10, 1989, and on or before the 15th day of the 3rd month following the close of such taxable year, as being taken into account under section 563(c) of the Code by making such designation on an attachment to Schedule N of Form 5471. The designation must set forth the date and amount of the distribution, state that the dividend is designated under section 563(c), and be signed and dated by a duly authorized corporate officer of the foreign personal holding company. The dividend so designated will be included in computing the dividends paid deduction of the foreign personal holding company on Form 5471, Schedule N, Part II, Section B. The "Date paid" column on Schedule N should refer to

the attachment on which the designation is made.

SEC. 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 63-7, 1963-1 C.B. 485; Rev. Proc. 75-54, 1975-2 C.B. 594; and Rev. Proc. 76-35, 1976-2 C.B. 658, are modified.

SEC. 6. EFFECTIVE DATES

Section 3 of this revenue procedure is effective for the first taxable year of a specified foreign corporation described in section 898(b) of the Code which begins after July 10, 1989. Section 4 of this revenue procedure is effective for the taxable years of a foreign personal holding company which begin after July 10, 1989.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 170, 501, 509, 521, 4942, 7428; 1.170A-1, 1.501(a)-1, 1.509(a)-1, 1.521-1, 53.4942(b)-1, 1.9100-1)

Rev. Proc. 90-27

SECTION 1. PURPOSE

This revenue procedure sets forth revised procedures with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Internal Revenue Code and with respect to revocation or modification of exemption rulings and determination letters other than those subject to Rev. Proc. 80-30, 1980-1 C.B. 685 (relating to pension, annuity, profit-sharing, and stock bonus plans). This revenue procedure also supplements Rev. Proc. 76-34, 1976-2 C.B. 656, with respect to the effects of section 7428 on the classification of organizations under sections 509(a) and 4942(j)(3). See Rev. Proc. 80-27, 1980-1 C.B. 677, for procedures under which exemption may be recognized on a group basis for subordinate organizations affiliated with and under the general supervision and control of a central organization. Also, see Rev. Proc. 72-5, 1972-1 C.B. 709, for information on applications for recognition of exemption filed by certain religious and apostolic organizations. Requests for rulings or determination letters generally are governed by the procedures outlined in Rev. Proc. 90-4, page 410, this Bulletin. Rev. Proc. 90-17, page 479, this Bulletin, sets forth the procedures for the charging of user fees for the issuance of rulings and determination letters.

SEC. 2. NATURE OF CHANGES

This revenue procedure updates and restates the procedures previously set forth in Rev. Proc. 84-46, 1984-1 C.B. 541, and Rev. Proc. 85-32, 1985-2 C.B. 414, relating to processing requests for exemption. Since bylaws are not organizing or enabling documents, section 5.05 has been amended to remove the requirement that such documents must be signed when attached to an application. The list of exempt organization key Districts has been updated. Also, as appropriate, the term "authorized individual" has been substituted for other terms previously used when referring to individuals who have the authority to act on the organization's behalf. Payment of the correct user fee is added as a requirement for a substantially completed Form 1023.

SEC. 3. GENERAL

.01 When used in this revenue procedure, the term "key District Director" means the District Director of one of the 7 key district offices for exempt organization matters.

.02 The term "determination letter" refers to a letter issued by a key District Director, or an Appeals Office in the case of an exemption application, in response to a written inquiry by an individual or an organization that applies to the particular facts involved, and to the principles and precedents previously announced by the National Office. This includes a letter issued on the basis of advice secured from the National Office pursuant to the procedures prescribed herein and in Rev. Proc. 90-5, page 421, this Bulletin. The term "ruling" refers to a letter issued by the National Office.

.03 The declaratory judgment provisions of section 7428 of the Code, with regard to this revenue procedure, apply to an actual controversy involving a determination by the Service or a failure of the Service to make a determination with respect to the initial or continuing qualification or classification of an organization under section 501(c)(3) (charitable, educational, etc.); 170(c)(2) (deductibility of contributions); 509(a) (private foundation status); or 4942(j)(3) (operating foundation status).

SEC. 4. FILING AND PROCESSING APPLICATIONS FOR RECOGNITION OF EXEMPTION

An organization seeking recognition of exempt status under section 501 or 521 of the Code is required to file an application with the key District Director for the Internal Revenue District in which its principal place of business is located. The 7 key district offices that process the applications, the Internal Revenue districts covered by each, and the regional office designations are as follows:

Key District(s)	IRS Districts Covered
	CENTRAL REGION
Cincinnati	Cincinnati, Cleveland, Detroit, Indianapolis, Louisville, and Parkersburg.
	MID-ATLANTIC REGION
Baltimore	Baltimore (includes District of Columbia), Newark, Philadelphia, Pittsburgh, Puerto Rico, Richmond, Wilmington, and matters relating to a foreign organization, or an organization located in a territory or possession of the United States.

Key District(s)	IRS Districts Covered
	MIDWEST REGION
Chicago	Aberdeen, Chicago, Des Moines, Fargo, Helena, Milwaukee, Omaha, St. Louis, St. Paul, and Springfield.
	NORTH-ATLANTIC REGION
Brooklyn	Albany, Augusta, Boston, Brooklyn, Buffalo, Burlington, Hartford, Manhattan, Portsmouth, and Providence.
	SOUTHEAST REGION
Atlanta	Atlanta, Birmingham, Columbia, Fort Lauderdale, Greensboro, Jackson, Jacksonville, Little Rock, New Orleans, and Nashville.
	SOUTHWEST REGION
Dallas	Albuquerque, Austin, Cheyenne, Dallas, Denver, Houston, Oklahoma City, Phoenix, Salt Lake City, and Wichita.
	WESTERN REGION
Los Angeles	Anchorage, Boise, Honolulu, Laguna Niguel, Las Vegas, Los Angeles, Portland, Sacramento, San Francisco, San Jose, and Seattle.

SEC. 5. STANDARDS FOR ISSUING RULINGS OR DETERMINATION LETTERS WITH RESPECT TO EXEMPT STATUS

.01 A ruling or determination letter will be issued to an organization, provided its application and supporting documents establish that it meets the particular requirements of the section under which exemption is claimed. Any oral representation of additional facts or modification of facts as represented or alleged in the application for a ruling or determination letter must be reduced to writing over the signature of an authorized individual.

.02 Exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere restatement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures or other means adopted or planned for carrying out the activities, the anticipated sources of receipts, and the nature of contemplated expenditures. Where the organization cannot demonstrate to the satisfaction of the Service that its proposed activities will be exempt, a record of actual operations may be required before a ruling or determination letter will be issued. In those cases where an organization is unable to describe fully its purposes and activities, a refusal to issue a ruling or determination letter will be considered an initial adverse determination from which administrative appeal or protest rights will be afforded.

.03 Where an application for recognition of exemption does not contain the required information, the application may be returned to the applicant without being considered on its merits with an appropriate letter of explanation. In the case of an application under section 501(c)(3) of the Code that is returned, the applicant will also be informed of the time within which the completed application must be resubmitted in order for the application to be considered a timely notice within the meaning of section 508(a).

.04 A ruling or determination letter recognizing exemption will not ordinarily be issued if an issue involving the organization's exempt status under section 501 or 521 of the Code is pending in litigation or is under consideration within the Service.

.05 In the case of an application under section 501(c)(3) of the Code, the 270-day period referred to in section 7428(b)(2) will be considered by the Service to begin on the date a substantially completed Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, is filed with or mailed to the appropriate key District Director. A substantially completed Form 1023 is one that:

1 is signed by an authorized individual.

2 includes an Employer Identification Number (EIN) or a completed Form SS-4, Application for Employer Identification Number.

3 includes information regarding previously filed federal income tax and exempt organization information returns.

4 includes a statement of receipts and expenditures and a balance sheet for the current year and the three preceding years (or the years the organization was in existence, if less than four years). If the organization has not yet commenced operations, or has not completed one accounting period, a proposed budget for two full accounting periods and a current statement of assets and liabilities will be acceptable.

5 includes a narrative statement of proposed activities and a narrative description of anticipated receipts and contemplated expenditures.

6 includes a copy of the organizing or enabling document that is signed by a principal officer or is accompanied by a written declaration signed by an authorized individual certifying that the document is a complete and accurate copy of the origi-

nal or otherwise meets the requirements of a "conformed copy" as outlined in Rev. Proc. 68-14, 1968-1 C.B. 768.

7 if the organizing or enabling document is in the form of articles of incorporation, includes evidence that it was filed with and approved by an appropriate state official (e.g., stamped "Filed" and dated by the Secretary of State). Alternatively, a copy of the articles of incorporation may be submitted providing it is accompanied by a written declaration signed by an authorized individual that the copy is a complete and accurate copy of the original copy that was filed with and approved by the state. If a copy is submitted, the written declaration must include the date the articles were filed with the state.

8 if the organization has adopted by-laws, includes a current copy. The by-laws need not be signed if submitted as an attachment to the application for recognition of exemption. Otherwise, the by-laws must be verified as current by an authorized individual.

9 is accompanied by the correct user fee.

.06 If a Form 1023 does not contain all of the items set out in section 5.05, it will not be further processed and may be returned to the applicant for completion. The 270-day period will not be considered as starting until the date the Form 1023 is refiled with or remailed to the Service with the requested information, or, if remailed and a postmark is not evident, on the date the Service actually receives a substantially completed Form 1023.

.07 The standards of section 5.05 for a substantially completed application form apply also to applications for recognition of exemption under other paragraphs of section 501(c) of the Code. They also apply to the notice requirement of section 508. Even though an application is considered substantially complete, more information may be required before a ruling or determination letter can be issued.

.08 If the application for recognition of exemption involves an issue where contrary authorities exist, failure to disclose and distinguish significant contrary authorities may result in requests for additional information, which will delay action on the application (see section 8.08 of Rev. Proc. 90-4).

SEC. 6. ISSUING RULINGS OR KEY DISTRICT DETERMINATION LETTERS WITH RESPECT TO EXEMPT STATUS

.01 Under the general procedures outlined in Rev. Proc. 90-4, key District Directors are authorized to issue determination letters involving applications for recognition of exemption under sections 501 and 521 of the Code.

.02 A key District Director will refer to the National Office those applications that present questions the answers to which are not specifically covered by statute or regulations, or by a ruling, opinion, or court decision published in the Internal Revenue Bulletin. In addition, key District Directors will refer those applications that have been specifically reserved by revenue procedure and/or Internal Revenue Manual instructions for National Office handling for purposes of establishing uniformity or centralized control of designated categories of cases. The National Office will consider each such application, issue a ruling directly to the organization, and send a copy of the ruling to the key District Director.

.03 If at any time during the course of consideration of an exemption application the organization believes that its case involves an issue on which there is no published precedent or there is nonuniformity between districts, the organization should ask the key District Director to request technical advice from the National Office. See Rev. Proc. 90-5.

.04 If the key District Director proposes to recognize the exemption of an organization to which the National Office had issued a previous contrary ruling or technical advice, the key District Director must seek technical advice from the National Office before issuing a determination letter. See Rev. Proc. 90-5.

SEC. 7. WITHDRAWAL OF APPLICATIONS

.01 An application for recognition of exemption under section 501 or 521 of the Code may be withdrawn, upon the written request of an authorized individual at any time prior to the issuance of the initial adverse ruling or determination letter. Even though the application is withdrawn, however, the application and all supporting documents will be retained by the Service and will not be returned to the organization. See Sec. 6.13 of Rev. Proc. 90-17 regarding refunds of user fees.

.02 The Service will not consider the withdrawal of an application under section 501(c)(3) of the Code as either a failure to make a determination within the meaning of section 7428(a)(2) or as an exhaustion of administrative remedies within the meaning of section 7428(b)(2).

SEC. 8. NATIONAL OFFICE REVIEW OF DETERMINATION LETTERS

.01 Some determination letters issued by the key districts will be reviewed by the Exempt Organizations Technical Division, or the Office of the Assistant Chief Counsel (Pass-throughs and Special Industries) (for cases under section 521 of the Code), to assure uniform application of the statutes or regulations, or rulings, opinions, or court decisions published in the Internal Revenue Bulletin.

.02 Where the National Office takes exception to a key district determination letter, the key District Director will be advised. If the organization disagrees with the exception taken, the file will be returned to the National Office. The referral will be treated as a request for technical advice and sections 9, 10, and 11 of Rev. Proc. 90-5 will be followed.

SEC. 9. PROTEST OF INITIAL ADVERSE RULING LETTERS

In the case of an initial adverse ruling letter from the National Office, the organization will be informed of the basis for the conclusion, and of its right to file a protest within 30 days and to a conference in the National Office. If a conference is requested, the conference procedures outlined in section 9 of Rev. Proc. 90-4 apply.

SEC. 10. APPEAL OF INITIAL ADVERSE DETERMINATION LETTERS

.01 Upon the issuance of an initial adverse determination letter or a letter proposing revocation or modification of exempt status, the key District

Director will advise the organization of its right to appeal the determination by requesting Appeals Office consideration. To do this, the organization must submit to the key District Director within 30 days from the date of the letter, a statement of the facts, law, and arguments in support of its position. The organization must also state whether it wishes an Appeals Office conference.

.02 Any determination letter issued on the basis of National Office technical advice may not be appealed to the Appeals Office on issues that were the subject of the technical advice.

.03 Upon receipt of an organization's request for Appeals Office consideration, the key district will, if it maintains its position, forward the request and the case file to the Chief of the appropriate Appeals Office.

SEC. 11. CONSIDERATION AT THE APPEALS OFFICE

.01 The Appeals Office, after considering the organization's appeal and any additional information developed in conference, will advise the organization of its decision and issue the appropriate determination letter to the organization.

.02 Organizations should make full presentation of the facts, circumstances, and arguments at the initial level of consideration by the Appeals Office, since submission of additional facts, circumstances, and arguments may result in suspension of appeal procedures and referral of the case back to the key district for additional consideration. Any oral representation of additional facts originally represented or alleged must be reduced to writing.

.03 If the Appeals Office believes that an exemption or private foundation status issue is not covered by published precedent or that there is nonuniformity, the Appeals Office must request technical advice from the National Office. Unless the Appeals Office feels that the conclusions reached by the National Office should be reconsidered and promptly requests such consideration, the case will be disposed of by the Appeals Office on the basis of the decision in the technical advice memorandum. See Rev. Proc. 90–4.

.04 If at any time during the course of Appeals Office consideration, the organization believes that its case involves an issue on which there is no public precedent or there is nonuniformity between the districts, the organization should ask the Appeals Office to request technical advice from the National Office. See Rev. Proc. 90–4.

.05 If the proposed disposition by the Appeals Office is contrary to a prior National Office technical advice or ruling concerning this organization, the proposed disposition will be submitted through the Office of the Regional Director of Appeals to the Assistant Commissioner (Employee Plans and Exempt Organizations), or, in a case under section 521 of the Code, to the Associate Chief Counsel (Technical). Unless the Appeals Office feels that the conclusions reached by the National Office should be reconsidered and promptly requests such consideration, the decision of the National Office will be followed by the Appeals Office. In any event, the Assistant Commissioner or the Associate Chief Counsel will make the final decision.

SEC. 12. EXHAUSTION OF ADMINISTRATIVE REMEDIES FOR DECLARATORY JUDGMENT PURPOSES

.01 Section 7428 of the Code, in part, requires that an organization seeking initial or continuing recognition of exemption under section 501(c)(3) must exhaust its administrative remedies by taking timely, reasonable steps to secure a determination prior to filing for declaratory judgment. Those steps and administrative remedies required to be exhausted within the Service are:

1 the filing of a substantially completed application Form 1023 pursuant to section 5.05 or the filing of a request for a determination of foundation status pursuant to Rev. Proc. 76–34;

2 in appropriate cases, requesting relief pursuant to section 1.9100 of the Income Tax Regulations regarding applications for extension of the time for making an election or application for relief from tax (see Rev. Proc. 79–63, 1979–2 C.B. 578);

3 the timely submission of all additional information requested by the Service to perfect an exemption application or request for determination of private foundation status; and

4 exhaustion of all administrative appeals available within the Service pursuant to sections 10 and 11 or protest of an initial adverse ruling pursuant to section 9 in National Office original jurisdiction exemption application cases.

.02 An organization will in no event be deemed to have exhausted its administrative remedies prior to the earlier of:

1 the completion of the steps in section 12.01, and the sending by certified or registered mail of a notice of final determination; or

2 the expiration of the 270-day period described in section 7428(b)(2) of the Code in a case where the Service has not issued a notice of final determination and the organization has taken, in a timely manner, all reasonable steps to secure a ruling or a determination.

.03 The steps described in section 12.01 will not be considered completed until the Service has had a reasonable time to act upon the appeal or protest as the case may be.

.04 A notice of final determination to which section 7428 of the Code applies is a ruling or determination letter, sent by certified or registered mail, which holds that the organization is not described in section 501(c)(3) or 170(c)(2), is a private foundation as defined in section 4942(j)(3), or is a public charity described in a part of section 509 or section 170(b)(1)(A) other than the part under which the organization requested classification.

SEC. 13. EFFECT OF RULINGS OR DETERMINATION LETTERS RECOGNIZING EXEMPTION

.01 A ruling or determination letter recognizing exemption is usually effective as of the date of formation of an organization if its purposes and activities during the period prior to the date of the ruling or determination letter were consistent with the requirements for exemption. However, for special rules regarding organizations formed after October 9, 1969, applying for exemption under section 501(c)(3) of the Code, see section 508(a) and Rev. Rul. 77–208, 1977–1 C.B. 153. If the organization is re-

quired to alter its activities or to make substantive amendments to its enabling instrument, the ruling or determination letter recognizing its exempt status will be effective as of the date specified therein. If a nonsubstantive amendment is made, exemption will ordinarily be recognized as of the date of formation. Examples of nonsubstantive amendments include correction of a clerical error in the enabling instrument or the addition of a dissolution clause where the activities of the organization prior to the ruling or determination are consistent with the requirements for exemption.

.02 A ruling or determination letter recognizing exemption may not be relied upon if there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of the organization.

SEC. 14. REVOCATION OR MODIFICATION OF RULINGS OR DETERMINATION LETTERS RECOGNIZING EXEMPTION

.01 A ruling or determination letter recognizing exemption may be revoked or modified by (1) a notice to the taxpayer to whom the ruling or determination letter originally was issued, (2) enactment of legislation or ratification of a tax treaty, (3) a decision of the United States Supreme Court, (4) issuance of temporary or final regulations, or (5) issuance of a revenue ruling, revenue procedure, or other statement published in the Internal Revenue Bulletin. The revocation or modification may be retroactive if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented, or, in the case of organizations to which section 503 applies, engaged in a prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purpose and such transaction involved a substantial part of the corpus or income of such organization. Where there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of an organization, revocation or modification will ordinarily take effect as of the date of such material change. In cases where a ruling or determination letter was issued in error or is no longer in accord with the holding of the Service, when section 7805(b) relief is granted (see sections 15 and 18 of Rev. Proc. 90–4), retroactivity of the revocation or modification ordinarily will be limited to a date not earlier than that on which the original ruling or determination letter is modified or revoked.

.02 In the case of a revocation or modification, the appeal and conference procedures are the same as set out in sections 10 and 11, including the right of the organization to request that the key District Director or the Chief, Appeals Office, seek technical advice from the National Office. If the case involves a status issue on which the National Office had issued a previous contrary ruling or technical advice, the key District Director generally must seek technical advice from the National Office. The key District Director does not have to seek technical advice if the prior ruling or technical advice has been revoked by subsequent contrary published precedent or if the proposed revocation involves a subordinate unit of an organization that holds a group exemption letter issued by the National Office, the National Office ruling or technical advice was issued under the Internal Revenue Code of 1939 or prior revenue acts, or if the ruling was issued in response to Form 4653, Notification Concerning Foundation Status.

.03 The provisions of section 10 and 11 relating to appeal and conference rights before a final revocation notice is issued are not applicable to matters where delay would be prejudicial to the interests of the Internal Revenue Service (such as in cases involving fraud, jeopardy, the imminence of the expiration of the statute of limitations, or where immediate action is necessary to protect the interests of the Government).

SEC. 15. EFFECT ON OTHER DOCUMENTS

Rev. Procs. 84–46 and 85–32 are superseded.

SEC. 16. EFFECTIVE DATE

This revenue procedure is effective the date of its publication in the Internal Revenue Bulletin.

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26 CFR 601.602: Tax forms and instructions.

Rev. Proc. 90-28

Requirements and Conditions for Filing Forms 8596, Information Returns for Federal Contracts, on Magnetic Tape, 5-1/4 and 3-1/2 Inch Magnetic Diskettes

NOTE: THIS REVENUE PROCEDURE MAY ONLY BE USED TO PREPARE MAGNETIC MEDIA SUBMISSIONS FOR CONTRACTS ENTERED INTO ON OR AFTER JANUARY 1, 1989. UPDATED COPIES OF THIS REVENUE PROCEDURE MAY BE PUBLISHED EACH YEAR. IRS STRONGLY ENCOURAGES FILERS TO REVIEW THEIR DATA FOR ACCURACY BEFORE SUBMISSION TO FACILITATE THE COLLECTION OF DELINQUENT FEDERAL TAX LIABILITIES FROM CONTRACTORS.

CONTENTS

PART A. GENERAL

SECTION 1. PURPOSE
SECTION 2. APPLICATION FOR MAGNETIC MEDIA REPORTING
SECTION 3. TEST FILES
SECTION 4. FILING REQUIREMENTS
SECTION 5. FILING OF MAGNETIC MEDIA REPORTS
SECTION 6. FILING DATES
SECTION 7. EXTENSIONS OF TIME TO FILE
SECTION 8. PROCESSING OF MAGNETIC MEDIA RETURNS
SECTION 9. HOW TO FILE CORRECTED RETURNS
SECTION 10. TAXPAYER IDENTIFICATION NUMBERS
SECTION 11. EFFECT ON PAPER RETURNS
SECTION 12. HOW TO CONTACT THE IRS MARTINSBURG COMPUTING CENTER
SECTION 13. DEFINITION OF TERMS
SECTION 14. STATE ABBREVIATIONS

PART B. RECORD SPECIFICATIONS
SECTION 1. GENERAL
SECTION 2. TAPE SPECIFICATIONS
SECTION 3. 5-1/4 AND 3-1/2 INCH DISKETTE SPECIFICATIONS
SECTION 4. PAYER/TRANSMITTER "A" RECORD
SECTION 5. PAYER/TRANSMITTER "A" RECORD - RECORD LAYOUT
SECTION 6. PAYEE "B" RECORD-GENERAL FIELD DESCRIPTIONS AND RECORD LAYOUTS
SECTION 7. END OF PAYER "C" RECORD
SECTION 8. END OF TRANSMISSION "F" RECORD

PART A. - GENERAL

SECTION 1. PURPOSE

.01 Section 6050M of the Internal Revenue Code, which was added by section 1522 of the Tax Reform Act of 1986 (Public Law 99-514) and amended by section 1015(f) of the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647), requires Federal executive agencies to file an information return with the Internal Revenue Service (IRS) reporting the name, address, and Taxpayer Identification Number (TIN) of each person with whom the agency enters into a contract, together with any other information required by Treasury regulations.

.02 The purpose of this revenue procedure is to provide the requirements and conditions for reporting information required on Forms 8596 and 8596-A, "Information Returns for Federal Contracts," on magnetic tape, 5-1/4 and 3-1/2 inch magnetic diskettes. For the purpose of this revenue procedure, magnetic tape, 5-1/4 and 3-1/2 inch magnetic diskettes will be referred to as "Media."

.03 *THIS REVENUE PROCEDURE APPLIES TO FEDERAL EXECUTIVE AGENCIES WITH RESPECT TO THEIR CONTRACTS (INCLUDING CONTRACT ACTIONS TREATED AS NEW CONTRACTS) ENTERED INTO (OR TREATED AS ENTERED INTO) ON OR AFTER JANUARY 1, 1989, EXCEPT THAT, WITH RESPECT TO A BASIC OR INITIAL CONTRACT ENTERED INTO BEFORE JANUARY 1, 1989, IT DOES NOT APPLY TO AN INCREASE CONTRACT ACTION TREATED AS A NEW CONTRACT IF THE INCREASE OCCURS BEFORE APRIL 1, 1990, OR IF THE INCREASE IS NOT IN EXCESS OF $50,000.*

PLEASE READ THIS REVENUE PROCEDURE CAREFULLY. IT MAY BE UPDATED YEARLY TO REFLECT NECESSARY CHANGES.

.04 *EXCEPTIONS.* The following are not required to be reported under section 6050M:

(a) Any basic or initial contract entered into before January 1, 1989;
(b) Any increase contract action occurring before January 1, 1989, that is treated as a new contract;
(c) Any contract action of $25,000 or less;
(d) Any increase contract action that is treated as a new contract if the basic or initial contract to which that contract action relates was entered into before January 1, 1989, and (i) the increase occurs before April 1, 1990, or (ii) the increase is not in excess of $50,000;
(e) Any contract with a contractor who, in making the agreement, is acting in his or her capacity as an employee of a Federal executive agency (e.g., any contract of employment under which the employee is paid wages subject to Federal income tax withholding);
(f) Any contract between a Federal executive agency and another Federal governmental unit (or agency or instrumentality thereof);
(g) Any contract with a person who is not required to have a TIN, such as a nonresident alien, foreign corporation or foreign partnership, any of which do not have income effectively connected with the conduct of a trade or business in the United States and does not have an office or place of business as a fiscal or paying agent in the U. S.;
(h) Contracts with a foreign government, a state or local governmental unit (or agency or instrumentality thereof);
(i) Any contract which provides that all amounts payable under the contract by a Federal executive agency will be paid on or before the 120th day following the date of the contract action and for which it is reasonable to expect that all amounts will be so paid;
(j) Any contract under which all money (or other property) that will be received by the contractor after the 120th day after the date of the contract action will come from persons other than a Federal executive agency or an agent of such an agency (e.g., a contract under which the contractor will collect amounts owed to a Federal executive agency by the agency's debtor and will remit to the agency the money collected less an amount that serves as the contractor's consideration under the contract);
(k) Certain confidential or classified contracts that meet the requirements of section 6050M(e);
(l) Contracts entered into using nonappropriated funds.

.05 The regulations contain further self-explanatory exceptions to the reporting requirements.

.06 The information required to be reported to the Internal Revenue Service (IRS) under section 6050M must be compiled on a quarterly basis (calendar quarters) and submitted on magnetic media to the IRS Martinsburg Computing Center (MCC), on or before the last day of the calendar month following the end of the quarter. See Part A, Sec. 12.

.07 A special reporting rule permitting the use of paper reporting on Forms 8596 and 8596-A is provided for those Federal executive agencies that reasonably expect to enter into *less than 250 contracts per annual period beginning October 1.* See Part A, Sec. 11.

.08 Federal executive agencies that are required to use magnetic media are permitted to submit more than one magnetic media submission per quarter. Each separate submission covers all the contracts and contract actions required to be reported for the quarter for one or more readily

identifiable operating functions of the Federal executive agency.

SEC. 2. APPLICATION FOR MAGNETIC MEDIA REPORTING

.01 For purposes of this revenue procedure, the *PAYER* is the agency making payments, and the *TRANSMITTER* is the organization preparing the magnetic media file. Payer and transmitter may be the same organization. Payers or their transmitters are required to complete Form 4419, "Application for Magnetic Media Reporting of Information Returns."

.02 Copies of Form 4419, for your use are included in this publication. Requests for additional information or forms related to magnetic media processing should be addressed to the IRS/MCC. The address is listed in Part A, Sec. 12.

.03 IRS/MCC will act on an application and notify the applicant, in writing, of authorization to file. A five character alpha/numeric *Transmitter Control Code* (TCC) will be assigned and included in the approval letter. Magnetic media returns may not be filed with IRS until the application has been approved and a TCC assigned. This TCC will be entered in the Transmitter Control field of the "A" Record. Do not enter blanks.

IRS encourages filers to submit one application and to use one Transmitter Control Code (TCC) for each area. However, an agency could have more than one TCC. If a filing agency has more than one TCC, it must use more than one tape or diskette; i.e., one cannot use two TCC's on the same medium. They must be reported separately.

In some cases, a Federal executive agency may elect to have the Director of the Federal Procurement Data Center (FPDC) make the return required for certain contracts on its behalf. See Part A, Sec. 4.

.04 After you have received approval to file on magnetic media, you need not reapply each year; however, notify IRS in writing if:

(a) You change from diskette to tape filing or vice versa, or report using more than one type of magnetic media, a new TCC may be necessary.

(b) You discontinue filing on magnetic media for a year (your TCC may be reassigned).

(c) You have used a Service Agency to prepare your magnetic media but now find you have computer capability to do your own transmission, you must apply for your own TCC.

.05 If any of these conditions apply to you, contact IRS/MCC for clarification. Also, notify IRS/MCC in writing if you had hardware or software changes that would affect the characteristics of your magnetic media submission. Please use your TCC in all contacts with IRS.

.06 A single Form 4419 should be submitted, even if you file on more than one type of magnetic media (e.g., magnetic tape and 5-1/4 inch diskette). IRS will assign different TCCs to each type of medium.

SEC. 3. TEST FILES

.01 IRS will assist new filers with their initial magnetic media submission by reviewing a "*test file*" in advance of the filing season. Current filers who have had software or hardware changes may also wish to submit a "test file."

.02 If you are a new filer, you must submit an *Application Form 4419* before you send in a "TEST" file. If approved, you will be assigned a five character Alpha/Numeric Transmitter Control Code (TCC). This TCC must be entered in the TCC field of your "A" record.

.03 All "TEST" files must be submitted between October 1 and December 15 of each year. Do not submit "TEST" files after December 15. Only a sample hardcopy print that shows a sample of each type of record used (A, B, C, and F) may be submitted after December 15, and it must be postmarked before January 15.

.04 The information in the "A" record MUST be ACTUAL information—not FICTITIOUS. Clearly mark the hardcopy print as "TEST" data and include identifying information such as name, telephone number, and address of a person who can be contacted to discuss its acceptability. If your test file is acceptable, you will be sent an approval letter.

.05 With all "TEST" data submit a Form 4804 and 4802 (if you transmit for multiple payers), or computer generated substitutes, which includes your TCC, money amount, and total records. The Form 4804 contains a checkbox to indicate the type of file; e.g., original, correction, replacement, or test.

.06 The "TEST DATA" must be formatted according to the current revenue procedure.

.07 Approval to participate in the program does not imply endorsement by the IRS of the computer software or the quality of tax preparation services provided.

SEC. 4. FILING REQUIREMENTS

.01 The information returns required by this section with respect to contracts of a Federal executive agency entered into on or after January 1, 1989, must be filed on a quarterly basis for the calendar quarters ending on the last day of March, June, September and December, and on or before the last day of the month following that quarter for which the returns are being made. However, for this first year only (1989 and first three quarters of 1990) returns filed on or before October 31, 1990, will be considered timely filed. This extended due date applies to paper filers as well as magnetic media filers. See Part A, Sec. 6 for due dates.

.02 The information returns required by this section with respect to contracts of a Federal executive agency for each calendar quarter shall be made in one submission (or in multiple submissions, if permitted in accordance with section 1.08 of this revenue procedure).

.03 Any Federal executive agency that on any October 1 has a reasonable expectation of entering into *fewer than 250 contracts*, for the 1-year period beginning October 1, that are subject to the reporting requirements may make the information returns required by section 6050M for each quarter of that 1-year period on the prescribed paper Forms 8596 and 8596-A in accordance with the instructions accompanying such forms. These paper forms must be filed with the IRS Kansas City Service Center. See Part A, Sec. 11.

.04 *Election to have the Director of the Federal Procurement Data Center file returns on behalf of an agency.* If a Federal executive agency in complying with the requirements of the Fed-

eral Procurement Data System (FPDS) is required to submit to the Federal Procurement Data Center (FPDC), all the information with respect to one or more contracts required to be reported, that agency may, in lieu of making returns directly to the IRS with respect to those contracts, elect to have the Director of the FPDC (or his or her delegate) make the required returns with respect to all of those contracts on its behalf.

.05 In order to make this election for contracts entered into during a calendar quarter, the head of a Federal executive agency (or his or her delegate) shall attach to its submission to the FPDC for that quarter, a signed statement to the effect that (a) the Director of the FPDC (or his or her delegate) is authorized in accordance with an election under 26 CFR, Section 1.6050M-1(d)(5) to make on the agency's behalf the required returns for such contracts for that quarter; and (b) under the penalties of perjury, such official has examined the information to be submitted by the agency to the FPDC for making those returns and certifies that information to be, to the best of such official's knowledge and belief, a compilation of agency records maintained in the normal course of business for the purpose of providing the information necessary for making true, correct, and complete returns as required by section 6050M.

.06 An agency that elects to have the FPDC file its returns shall not make direct returns to the IRS, except for contracts for which FPDS does not require the necessary contract information to be submitted to FPDC.

.07 If, through the exercise of an option contained in a basic or initial contract or under any other rule of contract law, express or implied, the amount of money or other property obligated under the contract is increased by more than $25,000 in one contract action, then that action shall be treated as a new contract and must be reported to IRS for the calendar quarter in which the increase occurs.

SEC. 5. FILING OF MAGNETIC MEDIA REPORTS

.01 Form 4804, "Transmittal of Information Returns Reported on Magnetic Media," must accompany your magnetic media submissions. If you file for multiple agencies, you should also submit Form 4802, "Transmittal for Multiple Magnetic Media Reporting." (IRS encourages the use of a computer generated Form 4804 that includes all necessary information requested on the current form.) *Be sure to include Forms 4804, 4802 or computer generated substitute with your media shipment. DO NOT MAIL THE TAPES OR DISKETTES AND TRANSMITTAL DOCUMENTS SEPARATELY.*

.02 Paper information returns must be transmitted to the IRS Kansas City Service Center using Form 8596, "Information Return for Federal Contracts" and Form 8596-A, "Quarterly Transmittal of Information Returns for Federal Contracts." *Do not send returns filed on paper forms to the IRS/MCC.* See Part A, Sec. 11 for more information.

.03 An affidavit for Form 4804 must be signed by the head of the Federal executive agency (or his or her delegate), or if returns are being made on behalf of the agency by the FPDC, by the Director of the FPDC (or his or her delegate). That person must sign either the affidavit that appears on Form 4804 or the appropriate substitute affidavit set forth in this section 5.03.

To use the substitute affidavit, strike out the affidavit on Form 4804 and attach the appropriate signed and dated substitute affidavit, showing the signer's title. The substitute affidavits follow:

(a) *Returns made directly with the Internal Revenue Service by the Federal Executive Agency.*

"Under the penalties of perjury, I declare that I have examined this transmittal, and accompanying documents, that they are prepared pursuant to the requirements of section 6050M, and, to the best of my knowledge and belief, they are compiled from agency records maintained in the normal course of business for the purpose of making a true, correct, and complete return as required by section 6050M."

(b) *Returns made by the Director of FPDC on an agency's behalf.*

"Under the penalties of perjury, I declare that I have examined this transmittal, and accompanying documents, that they are prepared pursuant to the requirements of section 6050M and, to the best of my knowledge and belief, they are compiled from information submitted by the Federal executive agency to the FPDC pursuant to section 1.6050M-1(d)-(5)(i) for the purpose of making a true, correct, and complete return as required by section 6050M."

.04 If a Federal executive agency elects for a quarter to have the FPDC make returns on its behalf, the FPDC shall attach to the Form 4804 accompanying its magnetic media submission for that agency for that quarter a copy of that agency's signed statement making the election.

.05 DO NOT REPORT THE SAME INFORMATION ON PAPER FORMS THAT YOU REPORT ON MAGNETIC MEDIA. IF YOU REPORT PART OF YOUR RETURNS ON PAPER AND PART ON MAGNETIC MEDIA, BE SURE THAT DUPLICATE INFORMATION IS NOT INCLUDED ON BOTH. This does not mean that corrected documents should not be filed. If a return has been prepared and submitted improperly, you must file a corrected return as soon as possible. Refer to Part A, Sec. 9 for requirements and instructions on filing corrected returns.

.06 Before submitting magnetic media files, include the following:

(a) A signed Form 4804 or computer generated substitute.

(b) A Form 4802 if you transmit for multiple agencies and have the authority to sign the affidavit on Form 4804 as outlined above.

(c) The magnetic media with an external identifying label as described in Part B, Sec. 1.02. Be sure to include the proper sequence on this label.

(d) On the outside of the shipping container, include a Form 4801 or a substitute for the form which reads "DELIVER UNOPENED TO TAPE LIBRARY - MAGNETIC MEDIA REPORT-

ING - BOX ____ of ____." If there is only one container, mark the outside as Box *1* of *1*. For multiple containers, include the sequence (e.g., Box *1* of *33*, *2* of *33*, etc.).

(e) If you were granted an extension of time, include a copy of the *approval* letter with the magnetic media shipment. See Part A, Sec. 7 on how to request an extension of time.

.07 Files returned to you due to coding or format errors must be corrected and returned to IRS within 45 days of date of notice.

.08 Agencies are required to retain a copy of the information returns filed with IRS *for at least three years* or have the ability to reconstruct the data.

SEC. 6. FILING DATES

.01 The information returns required by this section with respect to contracts entered into on or after January 1, 1989, must be filed on a quarterly basis for the calendar quarters as follows:

QUARTER	*DUE DATE*
January, February, March	April 30
April, May, June	July 31
July, August, September	October 31
October, November, December	January 31

.02 The Director of the FPDC (or his or her delegate) shall make the required return for a quarter to IRS on or before the earlier of:

(a) 45 days following the date that the contract information is required to be submitted to the FPDC, or

(b) 90 days following the end of the calendar quarter for which the election is made, except that, if that calendar quarter ends September 30, 105 days following the end of that quarter.

.03 For any contract or increase required to be reported that was entered into on or after January 1, 1989, and on or before September 30, 1990, you may file the return any time on or before October 31, 1990. This extended due date applies to paper filers as well as magnetic media filers.

.04 If any due date falls on a Saturday, Sunday, or legal holiday, the due date is extended to the next day that is not a Saturday, Sunday, or legal holiday.

SEC. 7. EXTENSIONS OF TIME TO FILE

.01 If a payer or transmitter of returns on magnetic media or paper forms filed with IRS/MCC is unable to file any returns due by October 31, 1990, submit a letter to the IRS/MCC requesting an extension of time, in increments of 30 days, for a maximum of 60 days, as soon as you are aware an extension is necessary. If you find you need an extension for other quarters, please telephone IRS/MCC. See Part A, Sec. 12 for address and telephone number.

.02 In order to be considered, the request must be filed BEFORE the due date of the return. Extension requests are not granted automatically. Appproval or denial is based on administrative criteria and guidelines. You will be notified in writing by IRS of approval or denial.

.03 If an extension of time to file on magnetic media or paper forms is granted by the IRS/MCC, a copy of the letter granting the extension MUST be included with the transmittal Form 8596-A and Form 4804, or computer generated substitute, when the file is submitted.

.04 An approved extension is good for one tax year only.

.05 The extension request must be signed by the head of the Federal executive agency or his or her delegate, or the Director of the FPDC or his or her delegate.

SEC. 8. PROCESSING OF MAGNETIC MEDIA RETURNS

.01 All data received at the IRS/MCC for processing will be given the same protection as individual returns (Form 1040). Media will not be returned to the originator. Please open all returned files upon receipt because files are returned due to errors that must be corrected and returned to IRS/MCC within 45 days of date of notice or you may be subject to a failure to file penalty.

.02 Do not use special shipping containers for transmitting data to IRS/MCC. Because of the high volume of data received and shipping costs involved, IRS/MCC will not return them.

.03 Files will be returned to you for correction if they are unprocessable due to format or coding errors, or by the specific written request of the filer. Unprocessable files must be corrected and returned to the IRS/MCC within 45 days of date of notice.

.04 *PLEASE BE SURE THAT YOUR FORMAT AND CODING COMPLY WITH THIS REVENUE PROCEDURE, WHICH IS TO BE USED FOR THE PREPARATION OF THE QUARTERS OF THE CALENDAR YEAR THAT END ON THE LAST DAY OF MARCH, JUNE, SEPTEMBER AND DECEMBER.*

SEC. 9. HOW TO FILE CORRECTED RETURNS

.01 If corrections are necessary, file the complete document in the next filing quarter. If you file corrected returns on paper forms, submit Forms 8596 and 8596-A to the IRS Kansas City Service Center. See Part A, Sec. 11 for the address. If your complete file is in error, contact the IRS/MCC immediately. See Part A, Sec. 12 for the address.

.02 To distinguish between a correction and a replacement:
A correction is media submitted by the payer to correct records that were successfully processed by IRS, but contained erroneous information.
A replacement is media that IRS has returned to the payer or transmitter due to format errors encountered during processing. After necessary changes have been made, the media must be returned to IRS/MCC to be reinput.

SEC. 10. TAXPAYER IDENTIFICATION NUMBERS

.01 Contractors are required to furnish taxpayer identification numbers (TINs) to the agency. Refer to Part A, Sec. 13 for a definition of taxpayer identification number (TIN).

.02 The contractor's TIN is used to associate and verify amounts reported to IRS with corresponding amounts used for levy purposes. Therefore, it is particularly important that correct

social security and employer identification numbers for contractors be provided on magnetic media or paper forms submitted to IRS. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROS.*

.03 IRS validates the SSN by using the Name Control of the surname of the individual who has been assigned this number. For this reason, provide the surname in the First Payee Name Line and/or the Name Control in positions 8-11 of the "B" Record. Failure to provide this information may make it impossible for IRS to validate the SSN.

.04 The TIN to be furnished to IRS depends primarily upon the manner in which the account is maintained or set up on the agency's record. The payer and payee names and taxpayer identification numbers should be consistent with the names and numbers used on other tax returns. The TIN must be that of the contractor. If the contract is recorded in more than one name, furnish the TIN and name of one of the contractors. The TIN provided must be associated with the name of the contractor provided in the first name line of the Payee "B" Record.

.05 The charts following will help you determine the number to be furnished to IRS for contractors.

CHART 1. Guidelines for Social Security Numbers

For this type of contractor:	In the Taxpayer Identification Number field of the Payee "B" Record, enter the SSN of—	In the First Payee Name Line of the Payee "B" Record, enter the name of—
1. An individual.	The individual.	The individual.
2. A sole proprietorship.	The owner.	The owner.

CHART 2. Guidelines for Employer Identification Numbers

For this type of contractor:	In the Taxpayer Identification Number field of the Payee "B" Record, enter the EIN of—	In the First Payee Name Line of the Payee "B" Record, enter the name of—
1. Corporate.	The corporation.	The corporation.
2. A partnership account held in the name of the business.	The partnership.	The partnership.

SEC. 11. EFFECT ON PAPER RETURNS

.01 All paper Forms 8596 and 8596-A for both original and corrected returns should be filed with the IRS Kansas City Service Center, Kansas City, MO 64999-2222. Forms may be obtained by calling 1-800-424-FORM.

SEC. 12. HOW TO CONTACT THE IRS MARTINSBURG COMPUTING CENTER

.01 Magnetic media processing for all Federal agencies is centralized at the IRS/MCC. *Please direct all requests for IRS magnetic media related publications, information, extensions of time or forms to the following addresses:*

Postal Service
Internal Revenue Service/MCC
Post Office Box 1359
Martinsburg, WV 25401-1359

or

Land Carrier
Internal Revenue Service/MCC
Magnetic Media Reporting
Route 9 & Needy Road
Martinsburg, WV 25401

.02 Hours of operation at this address will be 8:30 A.M. until 6 P.M. Eastern Time Zone. The telephone number is (304) 263-8700.

.03 Requests for paper returns, publications or forms not related to magnetic media processing should be requested by calling the toll-free "Forms Only" number. See Part A, Sec. 11 for the number.

.04 IRS/MCC will process returns filed on magnetic media only. *All information returns, including corrections, filed on paper forms should be submitted to the IRS Kansas City Service Center (see Part A, Sec. 11 for more information), not the IRS/MCC.*

SEC. 13. DEFINITION OF TERMS

Element	*Description*
ß	Denotes a blank position. Enter blank(s) when this symbol is used (do *not* enter the letter "b"). This appears in numerous areas throughout the record descriptions.
Coding Range	Indicates the allowable codes for a particular type of statement.
Common Parent	A corporation that files its income tax returns on a consolidated basis for an affiliated group of corporations.
Contract	A. An obligation of a Federal executive agency to make payment of money (or other property) to a person in return for the sale of property, the rendering of services, or other consideration. A contract includes such an obligation arising from a written agreement between the agency and the contractor, an award or notice of award, a job order or task letter issued under a basic ordering agreement, a letter contract, an order that is effective only on written acceptance or performance, or certain increases in the amount obligated. B. Any subcontract entered into by the Small Business Administration (SBA) under a prime contract between the SBA and a procuring Federal executive agency pursuant to section 8 (a) of the Small Business Act (15 U.S.C. 637[a]), shall not be treated as a contract of the SBA but shall be treated as a contract of the procuring agency for purposes of this section. C. An order placed by a Federal executive agency, including the General Services Administration or the Department of Veterans Affairs under a Schedule Contract is a contract. D. It does *NOT* include debt instruments of the United States Government or of a Federal agency, such as Treasury notes, Treasury bonds, Treasury bills, savings bonds, or similar instruments. E. It does *NOT* include a blanket purchase agreement between one or more Federal executive agencies and one or more contractors. However, an order placed by a Federal executive agency under the terms of a blanket purchase agreement is a contract. F. It does *NOT* include a license granted by a Federal executive agency. G. It does NOT include an obligation of a contractor (other than a Federal executive agency) to a subcontractor. H. It does *NOT* include an obligation of a Federal executive agency to lend money, lease property to a lessee, or sell property.
Contractor	Any person who enters into a contract with a Federal executive agency.
EIN	Employer Identification Number that has been assigned by IRS.
Federal Executive Agency/Payer	A. Any executive agency (as defined in 5 U.S.C. 105) other than the General Accounting Office; B. Any military department (as defined in 5 U.S.C. 102); and C. The United States Postal Service and the Postal Rate Commission.
File	For purposes of this procedure, a file consists of all magnetic media records submitted by a Transmitter.
Payee	The contractor.
Payer/Federal Executive Agency	The Federal executive agency entering into the contract. The Payer/Federal executive agency will be held responsible for the completeness, accuracy and timely submission of magnetic media files.
Special Character	Any character that is not a numeral, a letter or a blank.
SSN	Social Security Number.
Taxpayer Identification Number (TIN)	May be either an EIN or SSN.
Transmitter	Person or organization preparing magnetic media file(s). May be Payer or agent of Payer.

Element	*Description*
Transmitter Control Code (TCC)	A *five* character alpha/numeric number assigned by IRS/MCC to the transmitter prior to actual filing on magnetic media. This number is inserted in the "A" Record of your files and must be present before the file can be processed. An application Form 4419 must be filed with IRS/MCC to receive this number. See Part A, Sec. 2. (Abbreviation for this term is TCC.)

SEC. 14. STATE ABBREVIATIONS

.01 You MUST use the following state abbreviations when developing the state code portion of address fields.

State	*Code*	*State*	*Code*	*State*	*Code*
Alabama	AL	Kentucky	KY	North Dakota	ND
Alaska	AK	Louisiana	LA	Ohio	OH
American Samoa	AS	Maine	ME	Oklahoma	OK
Arizona	AZ	Mariana Islands	MP	Oregon	OR
Arkansas	AR	Maryland	MD	Pennsylvania	PA
California	CA	Massachusetts	MA	Puerto Rico	PR
Colorado	CO	Michigan	MI	Rhode Island	RI
Connecticut	CT	Minnesota	MN	South Carolina	SC
Delaware	DE	Mississippi	MS	South Dakota	SD
District of Columbia	DC	Missouri	MO	Tennessee	TN
Florida	FL	Montana	MT	Texas	TX
Georgia	GA	Nebraska	NE	Utah	UT
Guam	GU	Nevada	NV	Vermont	VT
Hawaii	HI	New Hampshire	NH	Virginia	VA
Idaho	ID	New Jersey	NJ	Washington	WA
Illinois	IL	New Mexico	NM	West Virginia	WV
Indiana	IN	New York	NY	Wisconsin	WI
Iowa	IA	North Carolina	NC	Wyoming	WY
Kansas	KS				

PART B. - RECORD SPECIFICATIONS

SECTION 1. GENERAL

.01 The specifications contained in this part of the revenue procedure define the required format and contents of the records to be included in the magnetic media file. These specifications must be adhered to unless deviations have been specifically granted by IRS.

.02 An external label Form 5064 must appear on each tape and diskette submitted for processing. If diskettes are used and the operating system is not MS/DOS compatible, the operating system and hardware information MUST be provided. Failure to provide this information will result in the diskette being returned to the filer. The following information is needed:

(a) The transmitter's name.

(b) The five character TCC.

(c) Calendar quarter of the data. (Enter in tax year block.)

(d) Operating system software and hardware used to create the file (e.g., Apple MacIntosh/MacWrite V2.2).

(e) Document type (e.g., 8596).

(f) The total number of "B" Records after each "A" Record (this figure is taken from the "C" Records).

(g) A number assigned by the transmitter to the magnetic media.

(h) The sequence of each tape or diskette (e.g., 001 of 008, 002 of 008, etc. However, if your file is complete on one tape or diskette, the sequence will be 001 of 001).

The information on the external media label, Form 5064, will assist IRS in processing the file or in locating a file, should the transmitter request that it be returned due to errors.

.03 *IRS/MCC advises that special shipping containers not be used for transmitting data because they will not be returned.*

.04 A provision is made in the Payee "B" Records for Special Data Entries. These entries are optional. If the field is not utilized, enter blanks to maintain a fixed record length of 420 positions. This field is reserved for the filer's own personal use and may be used at the discretion of the filer to include information related to each individual return. IRS will not use information supplied in this field.

.05 All records must be a fixed length of 420 positions.

SEC. 2. TAPE SPECIFICATIONS

.01 In most instances, IRS can process any compatible tape files. Tape files must be EBCDIC, ASCII or BCD and must meet the following criteria:

(a) 9 track EBCDIC (Extended Binary Coded Decimal Interchange Code) with:

(1) Odd Parity.

(2) A density of 800, 1600, or 6250 BPI.

(3) If you use UNISYS Series 1100, you must submit an interchange tape.

(b) 9 track ASCII (American Standard Coded Information Interchange) with:

(1) Odd Parity.

(2) A density of 800, 1600, or 6250 BPI.

(c) 7 track BCD (Binary Coded Decimal) with:

(1) Either Even or Odd Parity.

(2) A density of 556 or 800 BPI.

IRS will accept and process 7 track tapes; however, 9 track is preferred.

Please be consistent in the use of recording codes and density on your files. If files are generated in more than one recording code and/or density, multiple shipments would be appreciated.

.02 All compatible tape files must have the following characteristics:

Type of tape - 0.5 inch (12.7 mm) wide, computer grade magnetic tape on reels of up to 2400 feet (731.52 m) within the following specifications:

(a) Tape thickness: 1.0 or 1.5 mils.

(b) Reel diameter: 10.5 inch (26.67 cm), 8.5 inch (21.59 cm), or 7 inch (17.78 cm).

(c) At this time, IRS cannot accept cartridge tape. However, we are exploring this possibility for the near future.

.03 Agencies who can substantially conform to these specifications, but who require some minor deviations, MUST contact the IRS/MCC. Tapes deviating from the specifications in this revenue procedure should not be submitted without prior approval from IRS/MCC.

.04 The tape records defined in this revenue procedure may be blocked or unblocked, subject to the following:

(a) A block must not exceed 25,200 tape positions.

(b) If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9s; however, the last block of the file may be filled with 9s or truncated. Do not pad a block with blanks.

(c) All records, except the Header and Trailer Labels, may be blocked.

(d) Records may not span blocks.

.05 Labeled or unlabeled tapes may be submitted.

.06 For the purposes of this revenue procedure the following must be used:

Tape Mark:

(a) Used to signify the physical end of the recording on tape.

(b) For even parity, use BCD configuration 001111 ("8421").

(c) May follow the header label and precede and/or follow the trailer label.

SEC. 3. 5-1/4 AND 3-1/2 INCH DISKETTE SPECIFICATIONS

.01 To be compatible, a diskette file must meet the following specifications:

(a) 5-1/4 or 3-1/2 inches in diameter.

(b) Data must be recorded in standard ASCII code.

(c) Records must be fixed length of 420 bytes per record.

(d) Delimiter character commas (,) must not be used.

(e) Positions 419 and 420 of each record have been reserved for carriage return/line feed (cr/lf) characters.

(f) Filename of IRSTAX must be used. If a file will consist of more than one diskette, the filename IRSTAX will contain a 3-digit numeric extension. This extension will indicate the sequence of the diskettes within the file. For example, the first diskette will be named IRSTAX.001, the second diskette will be IRSTAX.002, etc.

(g) A diskette file may consist of multiple diskettes as long as the filename conventions are adhered to.

(h) Diskettes must meet one of the following specifications:

Capacity	*Tracks*
1.44 mb	96tpi
1.2 mb	96tpi
720 kb	48tpi
360 kb	48tpi
320 kb	48tpi
180 kb	48tpi
160 kb	48tpi

Sides/Density	*Sector Size*
hd	512
hd	512
ds/dd	512
ds/dd	512
ds/dd	512
ss/dd	512
ss/dd	512

.02 IRS prefers that 5-1/4 and 3-1/2 inch diskettes be created using MS/DOS, however, diskettes created using other operating systems are acceptable. A test file submission is highly recommended for 5-1/4 and 3-1/2 inch diskettes, especially if the file is not MS/DOS (see Part A, Sec. 3 for instructions on submitting "test" files).

.03 Deviations from the prescribed formats are not acceptable. Diskettes deviating from the specifications in this revenue procedure may not be submitted without prior approval from IRS.

SEC. 4. PAYER/TRANSMITTER "A" RECORD

.01 Identifies the payer and transmitter of the file and provides parameters for the succeeding Payee "B" Records. IRS computer programs rely on the absolute relationship between the parameters and data fields in the "A" Record and the data fields in the "B" Records to which they apply.

.02 All records must be a fixed length of 420 positions.

.03 The "A" record MUST be the first record appearing after the header label.

.04 The number of "A" Records appearing on the media will dependon the number of agencies being reported. A separate "A" Record is required for each agency, as many payee "B" Records as needed, followed by the summary "C" Record. If you are reporting for more than one agency on a tape or diskette, then an "A" Record may follow your "C" Record (i.e., you have separate A, B, and C records for one agency followed by A, B, C records for the next agency, etc.).

.05 *RECORDS MAY NOT SPAN BLOCKS.* Do not begin any record at the end of a block and continue the same record into the next block.

.06 All alpha characters entered in the "A" Record should be uppercase.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD

NOTE: For all fields marked REQUIRED, you must provide the information described under Description and Remarks. For those fields not marked REQUIRED, you must allow for the field but may be instructed to enter blanks or zeros in the indicated media position(s) and for the indicated length. All records are now a fixed length of 420 positions.

Media Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "A".
2-3	Blank	2	Enter blanks.
4-6	Reel Sequence Number	3	The reel sequence number incremented by 1, for each medium on the file starting with 001. You may choose to enter blanks or zeros. IRS bypasses this information. You must indicate the proper sequence on the external label Form 5064.
7-15	Payer's Federal EIN	9	REQUIRED. Must be the valid 9-digit number assigned by IRS to the Federal executive agency. DO NOT ENTER BLANKS, HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROS.
16-19	Payer Name Control	4	The Name Control is developed by using the first four characters of the payer's name as used to file on other tax returns such as 941s etc. Disregard the word "the" when it is the first word of the name, unless the name contains only two words. LEAVE THIS FIELD BLANK IF THE NAME CONTROL IS NOT DETERMINABLE.
20-21	Blank	2	Enter blanks.
22	Type of Return	1	REQUIRED. Enter G.
23	Amount Indicator	1	REQUIRED. Enter 8. Total amount obligated under the contract.
24-43	Blank	20	Enter blanks.
44-48	Transmitter Control Code (TCC)	5	REQUIRED. Enter the five character Transmitter Control Code assigned by IRS. You must have a TCC to file data on this program.
49	Blank	1	Enter blank.
50-89	First Payer Name Line	40	REQUIRED. Must be present or files will be returned for correction. Enter the name of the Federal agency whose Federal EIN appears in positions 7-15 in the manner in which it is used in normal business. Any extraneous information must be deleted from the name line. Left-justify and fill with blanks.
90-129	Second PayerName Line	40	REQUIRED. Enter the name and title of the person to whom requests for an offset against any unpaid tax liability of the contractor can be sent. If enough space is not provided, please abbreviate.
130	Blank	1	Enter blank.
131-170	Payer Shipping Address	40	REQUIRED. Enter the address of the person to whom requests for an offset against any unpaid tax liability of the contractor can be sent.
171-210	Payer City, State and ZIP Code	40	REQUIRED. Enter the City, State and ZIP Code of the person to whom requests for an offset against any unpaid tax liability of the contractor can be sent. Left-justify and fill with blanks.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Media Position	Field Title	Length	Description and Remarks
211-290	Transmitter Name	80	REQUIRED. Enter the name of the Federal Agency transmitting the data in the manner in which it is used in normal business. If someone other than the Federal agency is transmitting data, enter the name of that person. The name of the Federal agency must be constant through the entire file. Left-justify and fill with blanks. If the payer and transmitter are the same, enter blanks in this field.
291-330	Transmitter Mailing Address	40	REQUIRED. Enter the mailing address of the Federal Agency transmitting the data. Left-justify and fill with blanks. If the payer and transmitter are the same, enter blanks in this field.
331-370	Transmitter City, State and ZIP Code	40	REQUIRED. Enter the City, State and ZIP Code of the Federal Agency transmitting the data. Left-justify and fill with blanks. If the payer and transmitter are the same, enter blanks in this field.
371-420	Blank	50	Enter blanks.

SEC. 5. PAYER/TRANSMITTER "A" RECORD - RECORD LAYOUT

RECORD TYPE	BLANK	REEL SEQUENCE NUMBER	PAYER'S FEDERAL EIN	PAYER NAME CONTROL	BLANK
1	2-3	4-6	7-15	16-19	20-21

TYPE OF RETURN	AMOUNT INDICATOR	BLANK	TRANSMITTER CONTROL CODE	BLANK	FIRST PAYER NAME	SECOND PAYER NAME
22	23	24-43	44-48	49	50-89	90-129

BLANK	PAYER SHIPPING ADDRESS	PAYER CITY, STATE AND ZIP CODE	TRANSMITTER NAME	TRANSMITTER MAILING ADDRESS
130	131-170	171-210	211-290	291-330

TRANSMITTER CITY, STATE AND ZIP CODE	BLANK
331-370	371-420

SEC. 6. PAYEE "B" RECORD - GENERAL FIELD DESCRIPTIONS AND RECORD LAYOUTS

.01 The Payee "B" Record contains payment information from the individual contracts. When filing information documents on media, the format for the Payee "B" Records will remain constant.

.02 All records must be a fixed length of 420 positions.

.03 Records may be blocked or unblocked but may not span blocks or exceed 25,200 positions. DO NOT PAD A BLOCK WITH BLANKS. If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9s; however, the last block of the file may be filled with 9s or truncated.

.04 IRS must be able to identify the surname associated with the TIN (SSN or EIN) furnished for a con-

tractor. The specifications below include a field in the payee records called "Name Control" in which the first four alphabetic characters of the payee's surname or last name are to be entered by the payer. The surname or last name should appear first in the First Payee Name Line of all Payee "B" Records; however, if your records have been developed using the first name first, a blank must appear between the first and last names.

.05 If payers are unable to determine the first four characters of the surname, the Name Control Field may be left blank; however, compliance with the following will facilitate IRS computer programs in generating the Name Control.

(a) The surname of the payee whose TIN (SSN or EIN) is shown in the Payee "B" Record should always appear first. If, however, you enter the first name first, you must leave a blank space between the first and last names.

(b) In the case of multiple payees, only the surname of the payee whose TIN (SSN or EIN) is shown in the Payee "B" Record, must be present in the First Payee Name Line. Surnames of any other payees in the record must be entered in the Second Payee Name Line.

.06 A Special Data Entries field is also provided in these specifications which may be used to record information for the filer's own personal use. IRS does not use the data provided in the Special Data Entries field.

.07 All alpha characters entered in the "B" Record should be uppercase.

.08 Do *not* use decimal points (.) to indicate dollars and cents on magnetic media.

.09 *IRS STRONGLY ENCOURAGES FILERS TO REVIEW DATA FOR ACCURACY BEFORE SUBMISSION TO FACILITATE THE COLLECTION OF DELINQUENT FEDERAL TAX LIABILITIES FROM CONTRACTORS. FILERS SHOULD BE ESPECIALLY CAREFUL THAT TAXPAYER NAMES, TINS AND INCOME AMOUNTS ARE CORRECT.*

RECORD NAME: PAYEE "B" RECORD

NOTE: For all fields marked REQUIRED, you must provide the information described under Description and Remarks. For those fields not marked REQUIRED, you must allow for the field but may be instructed to enter blanks or zeros in the indicated media position(s) and for the indicated length. All records are now a fixed length of 420 positions.

Media Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "B".
2-3	Payment Year	2	REQUIRED. Enter "90".
4	Quarter	1	Enter quarter; i.e., 1, 2, 3, or 4. NOTE: If you file for all of 1989 and the first three quarters of 1990, enter 3.
5-7	Blank	3	Enter blanks.
8-11	Name Control	4	In the case of an individual, enter the first 4 characters of the surname of the person whose TIN is being reported in position 15-23 of the "B" Record (the payee) to determine the Name Control. If the name that corresponds to the TIN is not included in the First or Second Payee Name Line every effort should be made to develop the correct name control of the name that corresponds to the TIN. Surnames of less than four (4) characters should be left-justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. In the case of a business, use the first four significant characters of the business name. Words such as "a", "an", and "of" are not considered significant. Disregard the word "the" when it is the first word of the name, unless there are only two words in the name. LEAVE THIS FIELD BLANK IF THE NAME CONTROL IS NOT DETERMINABLE. The only valid special characters are a dash (-) and ampersand (&). The following examples may be helpful to you in developing the Name Control:

Media Position	Field Title	Length	Description and Remarks
			Name — *Name Control* John Brown — BROW John A. Lee — LEE* James P. En Sr. — EN* John O'Neill — ONEI Mary Van Buren — VANB Juan De Jesus — DEJE John A. El-Roy — EL-R The Limited — THEL Joe McCarthy & Sons — MCCA El Nino Storm Co. — ELNI Marriott — MARR The First Bank — FIRS The Hideaway — THEH IRS — INTE A & B Cafe — A&BC *Name Controls of less than four (4) significant characters must be left-justified and blank filled.
12–13	Blank	2	Enter blanks.
14	Type of TIN	1	REQUIRED. This field is used to identify the Taxpayer Identification Number (TIN) in positions 15–23 as either an Employer Identification Number, a Social Security Number, or the reason no number is shown. Enter the appropriate code from the following table: *Type of TIN* — *TIN* — *Type of Contractor* 1 — EIN — A corporation or a partnership. 2 — SSN — An individual, including a sole proprietor. blank — N/A — If the type of TIN is not determinable, enter a blank. If a number is not obtainable due to legitimate cause; e.g., number applied for but not received, enter a blank.
15–23	Taxpayer Identification Number	9	REQUIRED. Enter the valid 9-digit Taxpayer Identification Number of the contractor (SSN or EIN, as appropriate). Where an identification number has been applied for but not received or where there is any other legitimate cause for not having an identification number, *enter blanks.* Refer to Part A, Sec. 10. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9s OR ALL ZEROS.*
24–32	Common Parents Federal TIN	9	REQUIRED. If applicable, enter the valid 9-digit number assigned to the contractor's common parent. If not applicable, enter blanks. See Part A, Sec. 13 for a definition of Common Parent. *DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9S OR ALL ZEROS.*
33–50	Blank	18	Enter blanks.
51–120	Zeros	70	REQUIRED. Enter zeros.

RECORD NAME: PAYEE "B" RECORD—Continued

Media Position	Field Title	Length	Description and Remarks
121–130	Total Amount Obligated Under The Contract	10	REQUIRED. The amount reported in this field represents Total Amount Obligated Under the Contract. The amount must be entered in U.S. dollars and cents. Do not enter dollar signs, commas, decimal points, or *NEGATIVE PAYMENTS*. Amount obligated MUST be right-justified and unused positions MUST be zero filled. If you are reporting a money amount in excess of 9999999999 (dollars and cents), it must be reported as follows: (a) The first Payee B record MUST contain 9999999999. (b) The second payee B record will contain the remaining money amount. DO NOT SPLIT THIS FIGURE IN HALF.
131–140	Zeros	10	REQUIRED. Enter zeros.
141–161	Blank	21	Enter blanks.
162–201	First Payee	40	REQUIRED. *The First Payee Name Name Line Line will always appear in positions 162–201. Do not enter address information in this field.* Enter the name of the contractor (preferably surname first if an individual) whose Taxpayer Identification Number appears in positions 15–23. If fewer than 40 characters are required, left-justify and fill unused positions with blanks.
202–241	Name of Common Parent	40	REQUIRED. If the contractor is a member of an affiliated group of corporations that files its income tax returns on a consolidated basis, enter the name of the common parent of the affiliated group. Name entered should match EIN in positions 24–32.
242–281	Payee Mailing Address	40	Enter mailing address of contractor. Left-justify, fill unused positions with blanks.
282–310	Payee City	29	REQUIRED. Enter the city, left-justified and fill the unused positions with blanks. *Do not enter state and ZIP Code information in this field.*
311–312	Payee State	2	REQUIRED. Enter the abbreviation for the state as shown in Part A, Sec. 14. You MUST use valid U.S. Postal Service *state* abbreviations for U.S. addresses.
313–321	Payee ZIP Code	9	REQUIRED. Enter the valid 9 digit ZIP Code assigned by the U.S. Postal Service. If only the first 5 digits are known, left-justify and *fill the unused positions with blanks*. Use this field for the ZIP Code *only*.
322–349	Blank	28	Enter blanks.
350–404	Special Data Entries	55	This portion of the Payee "B" Record may be used to record information for the filer's own purposes. If this field is not utilized, ENTER BLANKS.
405–410	Date of Contract	6	Enter the date of the contract action. Use MMDDYY (e.g., 021889).
411–416	Completion Date	6	Enter the expected date of completion of contract such as the contract delivery date under the contract schedule. Use MMDDYY. If completion date is not available, enter blanks.
417–420	Blank	4	Enter blanks.

PAYEE "B" RECORD - RECORD LAYOUT

RECORD TYPE	PAYMENT YEAR	BLANK	NAME CONTROL	BLANK	TYPE OF TIN	TAXPAYER IDENTIFICATION NUMBER
1	2-3	4-7	8-11	12-13	14	15-23

COMMON PARENT'S FEDERAL TIN	BLANK	ZEROS	TOTAL AMOUNT OBLIGATED UNDER THE CONTRACT	ZEROS	BLANK
24-32	33-50	51-120	121-130	131-140	141-161

FIRST PAYEE NAME LINE	NAME OF COMMON PARENT	PAYEE MAILING ADDRESS	PAYEE CITY	PAYEE STATE	PAYEE ZIP CODE
162-201	202-241	242-281	282-310	311-312	313-321

BLANK	SPECIAL DATA ENTRIES	DATE OF CONTRACT	DATE OF COMPLETION	BLANK
322-349	350-404	405-410	411-416	417-420

SEC. 7. END OF PAYER "C" RECORD

.01 THE "C" RECORD IS A FIXED RECORD LENGTH OF 420 POSITIONS. The Control Total field is 15 positions in length.

.02 The End of Payer "C" Record is a summary record for a given payer.

.03 The "C" Record will contain the total number of payees and the totals of the payment amounts of a given payer. The "C" Record must be written after the last Payee "B" Record for a given payer. For each "A" Record and group of "B" Records on the file, there must be a corresponding "C" Record.

.04 Payers/Transmitters must verify the accuracy of the totals in the "C" Record and must enter the totals on the transmittal, Form 4804, 4802 or computer generated substitute, which will accompany the shipment. The line used on Forms 4804 and 4802 to record the payment amount corresponds with the Amount Code used in the "A" Record.

RECORD NAME: END OF PAYER "C" RECORD

Media Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "C".
2-7	Number of Payees	6	REQUIRED. Enter the total number of Contractor "B" Records covered by the preceding Payer/Transmitter "A" Record. Right-justify and zero fill.
8-10	Blank	3	Enter blanks.
11-115	Zeros	105	Enter zeros.
116-130	Control Total	15	REQUIRED. Enter the grand total amount paid to contractors of all contracts present in the preceding Payee "B" Records. Right-justify.
131-145	Zeros	15	Enter zeros.
146-420	Blank	275	Enter blanks.

END OF PAYER "C" RECORD - RECORD LAYOUT

RECORD TYPE	NUMBER OF PAYEES	BLANK	ZEROS	CONTROL TOTAL	ZEROS	BLANK
1	2-7	8-10	11-115	116-130	131-145	146-420

SEC. 8. END OF TRANSMISSION "F" RECORD

.01 THE "F" RECORD IS A FIXED RECORD LENGTH OF 420 POSITIONS. The "F" Record is a summary of the number of payers and tapes or diskettes in the entire file.

.02 This record should be written after the last "C" Record of the *entire* file.

RECORD NAME: END OF TRANSMISSION "F" RECORD

Media Position	Field Title	Length	Description and Remarks
1	Record Type	1	REQUIRED. Enter "F".
2-5	Number of "A" Records	4	You may enter the total number of Payer/Transmitter "A" Records in this transmission. Right-justify and zero fill or enter all zeros.
6-30	Zeros	25	Enter zeros.
31-420	Blank	390	Enter blanks.

END OF TRANSMISSION "F" RECORD - RECORD LAYOUT

RECORD TYPE	NUMBER OF "A" RECORDS	ZEROS	BLANK
1	2-5	6-30	31-420

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, Section 521; 1.521-1.)

Rev. Proc. 90-29

SECTION 1. PURPOSE

This revenue procedure revokes Rev. Proc. 73-39, 1973-2 C.B. 502.

SEC. 2. BACKGROUND

.01 Section 521(b)(2) of the Internal Revenue Code provides, in part, that exemption as a farmers' cooperative shall not be denied any association because it has capital stock, if substantially all such stock (other than nonvoting preferred stock) is owned by producers who market their products or purchase their supplies and equipment through the association.

.02 Rev. Proc. 73-39 provides, in part, that the Internal Revenue Service will consider the stock ownership test under section 521(b)(2) of the Code to be satisfied if, during the cooperative's taxable year, substantially all of the cooperative's stock is owned by persons who market through the cooperative more than 50 percent of the products they have produced, or who purchase from the cooperative more than 50 percent of their supplies and equipment of the type handled by the cooperative.

.03 The Tax Court rejected the 50-percent patronage requirement of Rev. Proc. 73-39 in *Farmers Cooperative Company v. Commissioner*, 89 T.C. 682 (1987), *acq.*, 1988-2 C.B. 1, concluding that the patronage requirement of section 521(b)(2) of the Code is qualitative, not quantitative. Thus, stock owned by persons who transact any amount of current and active patronage with an exempt cooperative during the cooperative's taxable year will be considered owned by "producers who market their products or purchase their supplies and equipment through the association" for purposes of the stock ownership requirement of section 521(b)(2). However, a person who transacts no patronage whatsoever during the cooperative's taxable year may still be considered a producer under section 521(b)(2) if, upon consideration of all the facts and circumstances, it is determined that such person was unable to transact any patronage during the year because (a) such person encountered a crop failure and had nothing to market, (b) sickness, disability, death, or other hardship prevented such person from transacting any patronage, or (c) the cooperative deals in items such as farm machinery which are not normally purchased on an annual basis.

SEC. 3. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 73-39 is revoked. Although the revocation is generally effective for all tax years, this revenue procedure will not be applied retroactively to the extent a taxpayer relied on Rev. Proc. 73-39.

26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 170, 664, 2055, 2522; 1.170A-6, 1.664-3, 20.2055-2, 25.2522(c)-3.)

Rev. Proc. 90-30

SECTION 1. PURPOSE

This revenue procedure makes available five sample forms of trust that meet the requirements for a charitable remainder unitrust as described in section 664(d)(2) of the Internal Revenue Code.

SEC. 2. BACKGROUND

The Internal Revenue Service receives and responds to requests for rulings dealing with the qualification of trusts as charitable remainder trusts and the availability of deductions for contributions made to such trusts. In many of these requests, the trust instruments and charitable objectives are very similar. Consequently, in order to provide a service to taxpayers and to save the time and expense involved in requesting and processing a ruling on a proposed charitable remainder unitrust, this revenue procedure allows taxpayers who make transfers to a trust that substantially follows one of the sample forms of trust contained herein to be assured that the Service will recognize the trust as meeting all of the requirements of a charitable remainder unitrust, provided that the trust operates in a manner consistent with the terms of the instrument creating the trust and provided it is a valid trust under applicable local law.

SEC. 3. SCOPE AND OBJECTIVE

Section 4 of Rev. Proc. 89-20, 1989-1 C.B. 841, provides a sample form of trust for an inter vivos charitable remainder unitrust providing for unitrust payments during one life that meets all of the applicable requirements of section 664(d)(2) of the Code. This revenue procedure amplifies Rev. Proc. 89-20 by providing the following additional sample forms of trust.

Sec. 4—Sample Inter Vivos Charitable Remainder Unitrust: Two Lives, Consecutive Interests;

Sec. 5—Sample Inter Vivos Charitable Remainder Unitrust: Two Lives, Concurrent and Consecutive Interests;

Sec. 6—Sample Testamentary Charitable Remainder Unitrust: One Life;

Sec. 7—Sample Testamentary Charitable Remainder Unitrust: Two Lives, Consecutive Interests; and

Sec. 8—Sample Testamentary Charitable Remainder Unitrust: Two Lives, Concurrent and Consecutive Interests.

In all cases, the termination of the life interests must be followed by distribution of the trust assets to the charitable remainder beneficiary, and the trust must be a valid trust under applicable local law. If the trust provisions are substantially similar to those in one of the samples provided in sections 4 through 8 of this revenue procedure or in section 4 of Rev. Proc. 89-20, the Service will recognize the trust as satisfying all of the applicable requirements of section 664(d)(2) of the Code and the corresponding regulations. A document will be considered to be substantially similar to one of the samples even though, for example, the wording is varied to comport with local law and practice as necessary to create trusts, define legal relationships, pass property by bequest, provide for the appointment of alternative and successor trustees, or designate alternative charitable remaindermen. Moreover, for transfers to a qualifying charitable remainder unitrust, the remainder interest will be deductible under sections 170(f)(2)(A), 2055(e)(2)(A), and 2522(c)(2)(A) for income, estate, and gift tax purposes, respectively, if the charitable remainder beneficiary otherwise meets all of the requirements of those provisions. Therefore, it will not be necessary for a taxpayer to request a ruling on the qualification of a substantially similar trust. A trust that contains substantive provisions in addition to those provided by sections 4 through 8 of this revenue procedure or by section 4 of Rev. Proc. 89-20 (other than provisions necessary to establish a valid trust under applicable local law) or that omits any of these provisions will not necessarily be disqualified but neither will it be assured of qualification under the provisions of this revenue procedure.

SEC. 4. SAMPLE INTER VIVOS CHARITABLE REMAINDER UNITRUST: TWO LIVES, CONSECUTIVE INTERESTS

On this _____ day of _____, 19__, I, _____ (hereinafter referred to as "the Donor"), desiring to establish a charitable remainder unitrust, within the meaning of section 4 of Rev. Proc. 90-30 and section 664(d)(2) of the Internal Revenue Code (hereinafter referred to as "the Code") hereby create the _____ Charitable Remainder Unitrust and designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Funding of Trust.* The Donor transfers to the Trustee the property described in Schedule A, and the Trustee accepts such property and agrees to hold, manage, and distribute such property of the Trust under the terms set forth in this Trust instrument.

2. *Payment of Unitrust Amount.* In each taxable year of the Trust, the Trustee shall pay to [a living individual] during his or her lifetime, and after his or her death to [a living individual] (hereinafter referred to as "the Recipients"), for such time as he or she survives, a unitrust amount equal to [*at least 5*] percent of the net fair market value of the assets of the Trust valued as of the first day of each taxable year of the Trust (the "valuation date"). The unitrust amount shall be paid in equal quarterly amounts from income and, to the extent that income is not sufficient, from principal. Any income of the Trust for a taxable year in excess of the unitrust amount shall be added to principal. If for any year the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee 'shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the unitrust amount properly payable and the unitrust amount actually paid.

3. *Payment of Federal Estate Taxes and State Death Taxes.* The life-

time unitrust interest of the second Recipient will take effect upon the death of the first Recipient only if the second Recipient furnishes the funds for payment of any federal estate taxes or state death taxes for which the Trustee may be liable upon the death of the first Recipient. [*This provision is mandatory only if all or a portion of the trust may be subject to such taxes on the death of the first recipient.*]

4. *Proration of the Unitrust Amount.* In determining the unitrust amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the survivor Recipient's death.

5. *Distribution to Charity.* Upon the death of the survivor Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due either of the Recipients or their estates under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c), 2055(a), and 2522(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c), 2055(a), and 2522(a) as the Trustee shall select in its sole discretion.

6. *Additional Contributions.* If any additional contributions are made to the Trust after the initial contribution, the unitrust amount for the year in which the additional contribution is made shall be [*the same percentage as in paragraph 2*] percent of the sum of (a) the net fair market value of the Trust assets as of the valuation date (excluding the assets so added and any income from, or appreciation on, such assets) and (b) that proportion of the fair market value of the assets so added that was excluded under (a) that the number of days in the period that begins with the date of contribution and ends with the earlier of the last day of the taxable year or the date of death of the survivor Recipient bears to the number of days in the period that begins on the first day of such taxable year and ends with the earlier of the last day in such taxable year or the date of death of the survivor Recipient. In the case where there is no valuation date after the time of contribution, the assets so added shall be valued as of the time of contribution.

7. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the unitrust amount to the Recipients, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

8. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

9. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____. The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(2) of the Code and the corresponding regulations.

10. *Limited Power of Amendment.* The Trust is irrevocable. The Trustee, however, shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of section 664(d)(2) of the Code.

11. *Investment of Trust Assets.* Nothing in this Trust instrument shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 5. SAMPLE INTER VIVOS CHARITABLE REMAINDER UNITRUST: TWO LIVES, CONCURRENT AND CONSECUTIVE INTEREST

On this _____ day of _____, 19__, I, _____ (hereinafter referred to as "the Donor"), desiring to establish a charitable remainder unitrust, within the meaning of section 5 of Rev. Proc. 90-30 and section 664(d)(2) of the Internal Revenue Code (hereinafter referred to as "the Code") hereby create the _____ Charitable Remainder Unitrust and designate _____ as the initial Trustee. [*Alternate or sucessor trustees may also be designated if desired.*]

1. *Funding of Trust.* The Donor transfers to the Trustee the property described in Schedule A, and the Trustee accepts such property and agrees to hold, manage, and distribute such property of the Trust under the terms set forth in this Trust instrument.

2. *Payment of Unitrust Amount.* In each taxable year of the Trust, the Trustee shall pay to _____ [a living individual] and _____ [a living individual] (hereinafter referred to as "the Recipients"), in equal shares during their lifetimes, a unitrust amount equal to [*at least 5*] percent of the net fair market value of the assets of the Trust valued as of the first day of each taxable year of the Trust (the "valuation date"). Upon the death of the first of the Recipients to die, the survivor Recipient shall be entitled to receive the entire unitrust amount. The unitrust amount shall be paid in equal quarterly amounts from income and, to the extent that income is not sufficient, from principal. Any income of the Trust for a taxable year in excess of the unitrust amount shall be added to principal. If for any year the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the unitrust amount properly payable and the unitrust amount actually paid.

3. *Payment of Federal Estate Taxes and State Death Taxes.* The lifetime unitrust interest of the survivor Recipient will continue in effect upon the death of the first Recipient to die only if the survivor Recipient furnishes the funds for payment of any federal estate taxes or state death

taxes for which the Trustee may be liable upon the death of the first Recipient to die. [*This provision is mandatory only if all or a portion of the trust may be subject to such taxes on the death of the first recipient to die.*]

4. *Proration of the Unitrust Amount.* In determining the unitrust amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the survivor Recipient's death.

5. *Distribution to Charity.* Upon the death of the survivor Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due either of the Recipients or their estates under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c), 2055(a), and 2522(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c), 2055(a), and 2522(a) as the Trustee shall select in its sole discretion.

6. *Additional Contributions.* If any additional contributions are made to the Trust after the initial contribution, the unitrust amount for the year in which the additional contribution is made shall be [*the same percentage as in paragraph 2*] percent of the sum of (a) the net fair market value of the Trust assets as of the valuation date (excluding the assets so added and any income from, or appreciation on, such assets) and (b) that proportion of the fair market value of the assets so added that was excluded under (a) that the number of days in the period that begins with the date of contribution and ends with the earlier of the last day of the taxable year or the date of death of the survivor Recipient bears to the number of days in the period that begins on the first day of such taxable year and ends with the earlier of the last day in such taxable year or the date of death of the survivor Recipient. In the case where there is no valuation date after the time of contribution, the assets so added shall be valued as of the time of contribution.

7. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the unitrust amount to the Recipients, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

8. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

9. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____. The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(2) of the Code and the corresponding regulations.

10. *Limited Power of Amendment.* The Trust is irrevocable. The Trustee, however, shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of section 664(d)(2) of the Code.

11. *Investment of Trust Assets.* Nothing in this Trust instrument shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 6. SAMPLE TESTAMENTARY CHARITABLE REMAINDER UNITRUST: ONE LIFE

All the rest, residue, and remainder of my property and estate, real and personal, of whatever nature and wherever situated, [*Alternatively, if not a residuary bequest, describe or identify the bequest*] I give, devise, and bequeath to my Trustee in trust. It being my intention to establish a charitable remainder unitrust within the meaning of section 6 of Rev. Proc. 90-30 and section 664(d)(2) of the Internal Revenue Code (hereinafter referred to as "the Code"), such Trust shall be known as the _____ Charitable Remainder Unitrust and I hereby designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Payment of Unitrust Amount.* In each taxable year of the Trust, the Trustee shall pay to [a living individual] (hereinafter referred to as "the Recipient") during the Recipient's life a unitrust amount equal to [*at least 5*] percent of the net fair market value of the assets of the Trust valued as of the first day of each taxable year of the Trust (the "valuation date"). The unitrust amount shall be paid in equal quarterly amounts from income and, to the extent that income is not sufficient, from principal. Any income of the Trust for a taxable year in excess of the unitrust amount shall be added to principal. If for any year the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipient (in the case of an undervaluation) or receive from the Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount properly payable and the unitrust amount actually paid.

2. *Deferral Provision.* The obligation to pay the unitrust amount shall commence with the date of my death, but payment of the unitrust amount may be deferred from such date until the end of the taxable year of the Trust in which occurs the complete funding of the Trust. Within a reasonable time after the end of the taxable year in which the complete funding of the Trust occurs, the Trustee must pay to the Recipient (in the case of an underpayment) or receive from the Recipient (in the case of an overpayment) the difference between: (1) any unitrust amounts actually paid, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 of the Code prescribe for the Trust for such computation for such period; and (2) the unitrust

amounts payable, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 prescribe for the Trust for such computation for such period.

3. *Proration of the Unitrust Amount.* In determining the unitrust amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the Recipient's death.

4. *Distribution to Charity.* Upon the death of the Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due the Recipient or the Recipient's estate under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c) and 2055(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c) and 2055(a) as the Trustee shall select in its sole discretion.

5. *Additional Contributions.* No additional contributions shall be made to the Trust after the initial contribution. The initial contribution, however, shall consist of all property passing to the Trust by reason of my death.

6. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the unitrust amount to the Recipient, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

7. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

8. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____. The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(2) of the Code and the corresponding regulations.

9. *Limited Power of Amendment.* The Trustee shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of section 664(d)(2) of the Code.

10. *Investment of Trust Assets.* Nothing herein shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 7. SAMPLE TESTAMENTARY CHARITABLE REMAINDER UNITRUST: TWO LIVES, CONSECUTIVE INTERESTS

All the rest, residue, and remainder of my property and estate, real and personal, of whatever nature and wherever situated, [*Alternatively, if not a residuary bequest, describe or identify the bequest*] I give, devise, and bequeath to my Trustee in trust. It being my intention to establish a charitable remainder unitrust within the meaning of section 7 of Rev. Proc. 90-30 and section 664(d)(2) of the Internal Revenue Code (hereinafter referred to as "the Code"), such Trust shall be known as the _____ Charitable Remainder Unitrust and I hereby designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Payment of Unitrust Amount.* In each taxable year of the Trust, the Trustee shall pay to [a living individual] during his or her lifetime, and after his or her death to [a living individual] (hereinafter referred to as "the Recipients"), for such time as he or she survives, a unitrust amount equal to [*at least 5*] percent of the net fair market value of the assets of the Trust valued as of the first day of each taxable year of the Trust (the "valuation date"). The unitrust amount shall be paid in equal quarterly amounts from income and, to the extent that income is not sufficient, from principal. Any income of the Trust for a taxable year in excess of the unitrust amount shall be added to principal. If for any year the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the unitrust amount properly payable and the unitrust amount actually paid.

2. *Deferral Provision.* The obligation to pay the unitrust amount shall commence with the date of my death, but payment of the unitrust amount may be deferred from such date until the end of the taxable year of the Trust in which occurs the complete funding of the Trust. Within a reasonable time after the end of the taxable year in which the complete funding of the Trust occurs, the Trustee must pay to the Recipients (in the case of an underpayment) or receive from the Recipients (in the case of an overpayment) the difference between: (1) any unitrust amounts actually paid, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 of the Code prescribe for the Trust for such computation for such period, and (2) the unitrust amounts payable, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 prescribe for the Trust for such computation for such period.

3. *Proration of the Unitrust Amount.* In determining the unitrust amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the survivor Recipient's death.

4. *Distribution to Charity.* Upon the death of the survivor Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due either of the Recipients of their estates under the provisions above) to _____ (hereinafter referred to as "the Charitable Organ-

ization"). If the Charitable Organization is not an organization described in sections 170(c) and 2055(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c) and 2055(a) as the Trustee shall select in its sole discretion.

5. *Additional Contributions.* No additional contributions shall be made to the Trust after the initial contribution. The initial contribution, however, shall consist of all property passing to the Trust by reason of my death.

6. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the unitrust amount to the Recipient, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

7. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

8. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____ . The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(2) of the Code and the corresponding regulations.

9. *Limited Power of Amendment.* The Trustee shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of section 664(d)(2) of the Code.

10. *Investment of Trust Assets.* Nothing herein shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 8. SAMPLE TESTAMENTARY CHARITABLE REMAINDER UNITRUST: TWO LIVES, CONCURRENT AND CONSECUTIVE INTERESTS

All the rest, residue, and remainder of my property and estate, real or personal, of whatever nature and wherever situated, [*Alternatively, if not a residuary bequest, describe or identify the bequest*] I give, devise, and bequeath to my Trustee in trust. It being my intention to establish a charitable remainder unitrust within the meaning of section 8 of Rev. Proc. 90-30 and section 664(d)(2) of the Internal Revenue Code (hereinafter referred to as "the Code"), such Trust shall be known as the _____ Charitable Remainder Unitrust and I hereby designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Payment of Unitrust Amount.* In each taxable year of the Trust, the Trustee shall pay to ___[a living individual] and ___[a living individual]___ (hereinafter referred to as "the Recipients"), in equal shares during their lifetimes, a unitrust amount equal to [*at least 5*] percent of the net fair market value of the assets of the Trust valued as of the first day of each taxable year of the Trust (the "valuation date"). Upon the death of the first of the Recipients to die, the survivor Recipient shall be entitled to receive the entire unitrust amount. The unitrust amount shall be paid in equal quarterly amounts from income and, to the extent that income is not sufficient, from principal. Any income of the Trust for a taxable year in excess of the unitrust amount shall be added to principal. If for any year the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the unitrust amount properly payable and the unitrust amount actually paid.

2. *Deferral Provision.* The obligation to pay the unitrust amount shall commence with the date of my death, but payment of the unitrust amount may be deferred from such date until the end of the taxable year of the Trust in which occurs the complete funding of the Trust. Within a reasonable time after the end of the taxable year in which the complete funding of the Trust occurs, the Trustee must pay to the Recipients (in the case of an underpayment) or receive from the Recipients (in the case of an overpayment) the difference between: (1) any unitrust amounts actually paid, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 of the Code prescribe for the Trust for such computation for such period; and (2) the unitrust amounts payable, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 prescribe for the Trust for such computation for such period.

3. *Proration of the Unitrust Amount.* In determining the unitrust amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the survivor Recipient's death.

4. *Distribution to Charity.* Upon the death of the survivor Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due either of the Recipients or their estates under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c) and 2055(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c) and 2055(a) as the Trustee shall select in its sole discretion.

5. *Additional Contributions.* No additional contributions shall be made to the Trust after the initial contribution. The initial contribution,

however, shall consist of all property passing to the Trust by reason of my death.

6. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the unitrust amount to the Recipient, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

7. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

8. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____ . The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(2) of the Code and the corresponding regulations.

9. *Limited Power of Amendment.* The Trustee shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of section 664(d)(2) of the Code.

10. *Investment of Trust Assets.* Nothing herein shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 9. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 89-20 is amplified.

SEC. 10. EFFECTIVE DATE

This revenue procedure is effective on and after June 18, 1990, the date of publication of this revenue procedure in the Internal Revenue Bulletin.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 170, 664, 2055, 2522; 1.170A-6, 1.664-3, 20.2055-2, 25.2522(c)-3.)

Rev. Proc. 90-31

SECTION 1. PURPOSE

This revenue procedure makes available six sample forms of trust that meet the requirements for a charitable remainder unitrust as described in section 664(d)(2) and (3) of the Internal Revenue Code.

SEC. 2. BACKGROUND

The Internal Revenue Service receives and responds to requests for rulings dealing with the qualification of trusts as charitable remainder trusts and the availability of deductions for contributions made to such trusts. In many of these requests, the trust instruments and charitable objectives are very similar. Consequently, in order to provide a service to taxpayers and to save the time and expense involved in requesting and processing a ruling on a proposed charitable remainder unitrust, this revenue procedure allows taxpayers who make transfers to a trust that substantially follows one of the sample forms of trust contained herein to be assured that the Service will recognize the trust as meeting all of the requirements of a charitable remainder unitrust, provided that the trust operates in a manner consistent with the terms of the instrument creating the trust and provided it is a valid trust under applicable local law.

SEC. 3. SCOPE AND OBJECTIVE

The sample forms of trust meet all of the applicable requirements of sections 664(d)(2) and (3) of the Code and include:

Sec. 4 — Sample Inter Vivos Charitable Remainder Unitrust: One Life;

Sec. 5 — Sample Inter Vivos Charitable Remainder Unitrust: Two Lives, Consecutive Interests;

Sec. 6 — Sample Inter Vivos Charitable Remainder Unitrust: Two Lives, Concurrent and Consecutive Interests;

Sec. 7 — Sample Testamentary Charitable Remainder Unitrust: One Life;

Sec. 8 — Sample Testamentary Charitable Remainder Unitrust: Two Lives, Consecutive Interests; and

Sec. 9 — Sample Testamentary Charitable Remainder Unitrust: Two Lives, Concurrent and Consecutive Interests.

In all cases, the termination of the life interests must be followed by a distribution of the trust assets to the charitable remainder beneficiary, and the trust must be a valid trust under applicable local law.

If the trust provisions are substantially similar to those in one of the samples provided in sections 4 through 9, the Service will recognize the trust as satisfying all of the applicable requirements of section 664(d)(2) and (3) of the Code and the corresponding regulations. A document will be considered to be substantially similar to one of the samples even though, for example, the wording is varied to comport with local law and practice as necessary to create trusts, define legal relationships, pass property by bequest, provide for the appointment of alternative and successor trustees, or designate alternative charitable remaindermen. Moreover, for transfers to a qualifying charitable remainder unitrust, the remainder interest will be deductible under sections 170(f)(2)(A), 2055(e)(2)(A), and 2522(c)(2)(A) for income, estate, and gift tax purposes, respectively, if the charitable remainder beneficiary otherwise meets all of the requirements of those provisions. Therefore, it will not be necessary for a taxpayer to request a ruling on the qualification of a substantially similar trust. A trust that contains substantive provisions in addition to those provided by sections 4 through 9 (other than provisions necessary to establish a valid trust under applicable local law) or that omits any of these provisions will not necessarily be disqualified, but it will not be assured of qualification under the provisions of this revenue procedure.

SEC. 4. SAMPLE INTER VIVOS CHARITABLE REMAINDER UNITRUST: ONE LIFE

On this ___ day of_____, 19__, I, _____ (hereinafter referred to as "the Donor"), desiring to establish a charitable remainder unitrust within the meaning of section 4 of Rev. Proc. 90-31 and section 664(d)(2) and (3) of the Internal Revenue Code (hereinafter referred to as "the Code") hereby create the_____ Charitable Remainder Unitrust and designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Funding of Trust.* The Donor transfers to the Trustee the property described in Schedule A, and the Trustee accepts such property and agrees to hold, manage, and distribute such property of the Trust under the terms set forth in this Trust instrument.

2. *Payment of Unitrust Amount.* In each taxable year of the Trust, the Trustee shall pay to [*a living individual*] (hereinafter referred to as "the Recipient") during the Recipient's life a unitrust amount equal to the lesser of: (a) the Trust income for the taxable year, as defined in section 643(b) of the Code and the regulations thereunder, and (b) [*at least 5*] percent of the net fair market value of the assets of the Trust valued as of the first day of each taxable year of the Trust (the "valuation date"). The unitrust amount for any year shall also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (b) (above) to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as [*same percentage as in (b) above*] percent of the net fair market value of the Trust assets on the valuation dates.

The unitrust amount shall be paid in quarterly installments. Any income of the Trust for a taxable year in excess of the unitrust amount shall be added to principal. If for any year the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipient (in the case of an undervaluation) or receive from the Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount properly payable and the unitrust amount actually paid.

3. *Proration of the Unitrust Amount.* In determining the unitrust amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the Recipient's death.

4. *Distribution to Charity.* Upon the death of the Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due the Recipient or the Recipient's estate under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c), 2055(a), and 2522(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c), 2055(a), and 2522(a) as the Trustee shall select in its sole discretion.

5. *Additional Contributions.* If any additional contributions are made to the Trust after the initial contribution, the unitrust amount for the year in which the additional contribution is made shall be equal to the lesser of (a) the Trust income for the taxable year, as defined in section 643(b) of the Code and the regulations thereunder, and (b) [*the same percentage as in paragraph 2*] percent of the sum of (1) the net fair market value of the Trust assets as of the valuation date (excluding the assets so added and any income from, or appreciation on, such assets) and (2) that proportion of the fair market value of the assets so added that was excluded under (1) that the number of days in the period that begins with the date of contribution and ends with the earlier of the last day of the taxable year or the day of the Recipient's death bears to the number of days in the period that begins on the first day of such taxable year and ends with the earlier of the last day in such taxable year or the day of the Recipient's death. In the case where there is no valuation date after the time of contribution, the assets so added shall be valued as of the time of contribution. The unitrust amount for any such year shall also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (b) above to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as [*same percentage as in (b) above*] percent of the net fair market value of the Trust assets on the valuation dates.

6. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the unitrust amount to the Recipient, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

7. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

8. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of . The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(2) and (3) of the Code and the corresponding regulations.

9. *Limited Power of Amendment.* The Trust is irrevocable. The Trustee, however, shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of section 664(d)(2) and (3) of the Code.

10. *Investment of Trust Assets.* Nothing in this Trust instrument shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 5. SAMPLE INTER VIVOS CHARITABLE REMAINDER UNITRUST: TWO LIVES, CONSECUTIVE INTERESTS

On this ___ day of _____, 19__, I, _____ (hereinafter referred to as "the Donor"), desiring to establish a charitable remainder unitrust within the meaning of section 5 of Rev. Proc. 90-31 and section 664(d)(2) and (3) of the Internal Revenue Code (hereinafter referred to as "the Code") hereby create the _____ Charitable Remainder Unitrust and designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Funding of Trust.* The Donor transfers to the Trustee the property described in Schedule A, and the Trustee accepts such property and agrees to hold, manage, and distribute such property of the Trust under the terms set forth in this Trust instrument.

2. *Payment of Unitrust Amount.* In each taxable year of the Trust, the Trustee shall pay to [*a living individual*] during his or her lifetime, and after his or her death, to [*a living individual*] (hereinafter referred to as "the Recipients"), for such time as he or she survives, a unitrust amount equal to the lesser of: (a) the Trust income for the taxable year, as defined in section 643(b) of the Code and the regulations thereunder, and (b) [*at least 5*] percent of the net fair market value of the assets of the Trust valued as of the first day of each taxable year of the Trust (the "valuation date"). The unitrust amount for any year shall also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (b) (above) to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as [*same percentage as in (b) above*] percent of the net fair market value of the Trust assets on the valuation dates.

The unitrust amount shall be paid in quarterly installments. Any income of the Trust for a taxable year in excess of the unitrust amount shall be added to principal. If for any year the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the unitrust amount properly payable and the unitrust amount actually paid.

3. *Payment of Federal Estate Taxes and State Death Taxes.* The lifetime unitrust interest of the second Recipient will take effect upon the death of the first Recipient only if the second Recipient furnishes the funds for payment of any federal estate taxes or state death taxes for which the Trustee may be liable upon the death of the first Recipient. [*This provision is mandatory only if all or a portion of the trust may be subject to such taxes on the death of the first recipient.*]

4. *Proration of the Unitrust Amount.* In determining the unitrust amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the survivor Recipient's death.

5. *Distribution to Charity.* Upon the death of the survivor Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due either of the Recipients or their estates under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c), 2055(a), and 2522(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c), 2055(a), and 2522(a) as the Trustee shall select in its sole discretion.

6. *Additional Contributions.* If any additional contributions are made to the Trust after the initial contribution, the unitrust amount for the year in which the additional contribution is made shall be equal to the lesser of (a) the Trust income for the taxable year, as defined in section 643(b) of the Code and the regulations thereunder, and (b) [*the same percentage as in paragraph 2*] percent of the sum of (1) the net fair market value of the Trust assets as of the valuation date (excluding the assets so added and any income from, or appreciation on, such assets) and (2) that proportion of the fair market value of the assets so added that was excluded under (1) that the number of days in the period that begins with the date of contribution and ends with the earlier of the last day of the taxable year or the date of death of the survivor Recipient bears to the number of days in the period that begins on the first day of such taxable year and ends with the earlier of the last day in such taxable year or the date of death of the survivor Recipient. In the case where there is no valuation date after the time of contribution, the assets so added shall be valued as of the time of contribution. The unitrust amount for any such year shall also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (b) above to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as [*same percentage as in (b) above*] percent of the net fair market value of the Trust assets on the valuation dates.

7. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the unitrust amount to the Recipients, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

8. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

9. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____. The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section

664(d)(2) and (3) of the Code and the corresponding regulations.

10. *Limited Power of Amendment.* The Trust is irrevocable. The Trustee, however, shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of section 664(d)(2) and (3) of the Code.

11. *Investment of Trust Assets.* Nothing in this Trust instrument shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 6. SAMPLE INTER VIVOS CHARITABLE REMAINDER UNITRUST: TWO LIVES, CONCURRENT AND CONSECUTIVE INTERESTS

On this ___ day of _____, 19__, I, _____ (hereinafter referred to as "the Donor"), desiring to establish a charitable remainder unitrust, within the meaning of section 6 of Rev. Proc. 90-31 and section 664(d)(2) and (3) of the Internal Revenue Code (hereinafter referred to as "the Code") hereby create the _____ Charitable Remainder Unitrust and designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Funding of Trust.* The Donor transfers to the Trustee the property described in Schedule A, and the Trustee accepts such property and agrees to hold, manage, and distribute such property of the Trust under the terms set forth in this Trust instrument.

2. *Payment of Unitrust Amount.* In each taxable year of the Trust, the Trustee shall pay to [*a living individual*] and [*a living individual*] (hereinafter referred to as "the Recipients") in equal shares during their lifetimes, a unitrust amount equal to the lesser of: (a) the Trust income for the taxable year, as defined in section 643(b) of the Code and the regulations thereunder, and (b) [*at least 5*] percent of the net fair market value of the assets of the Trust valued as of the first day of each taxable year of the Trust (the "valuation date"). The unitrust amount for any year shall also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (b) (above) to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as [*same percentage as in (b) above*] percent of the net fair market value of the Trust assets on the valuation dates.

Upon the death of the first of the Recipients to die, the survivor Recipient shall be entitled to receive the entire unitrust amount. The unitrust amount shall be paid in quarterly installments. Any income of the Trust for a taxable year in excess of the unitrust amount shall be added to principal. If for any year the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the unitrust amount properly payable and the unitrust amount actually paid.

3. *Payment of Federal Estate Taxes and State Death Taxes.* The lifetime unitrust interest of the survivor Recipient will continue in effect upon the death of the first Recipient to die only if the survivor Recipient furnishes the funds for payment of any federal estate taxes or state death taxes for which the Trustee may be liable upon the death of the first Recipient to die. [*This provision is mandatory only if all or a portion of the trust may be subject to such taxes on the death of the first recipient to die.*]

4. *Proration of the Unitrust Amount.* In determining the unitrust amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the survivor's death.

5. *Distribution to Charity.* Upon the death of the survivor Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due either of the Recipients or their estates under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c), 2055(a), and 2522(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c), 2055(a), and 2522(a) as the Trustee shall select in its sole discretion.

6. *Additional Contributions.* If any additional contributions are made to the Trust after the initial contribution, the unitrust amount for the year in which the additional contribution is made shall be equal to the lesser of (a) the Trust income for the taxable year, as defined in section 643(b) of the Code and the regulations thereunder, and (b) [*the same percentage as in paragraph 2*] percent of the sum of (1) the net fair market value of the Trust assets as of the valuation date (excluding the assets so added and any income from, or appreciation on, such assets) and (2) that proportion of the fair market value of the assets so added that was excluded under (1) that the number of days in the period that begins with the date of contribution and ends with the earlier of the last day of the taxable year or the date of death of the survivor Recipient bears to the number of days in the period that begins on the first day of such taxable year and ends with the earlier of the last day in such taxable year or the date of death of the survivor Recipient. In the case where there is no valuation date after the time of contribution, the assets so added shall be valued as of the time of contribution. The unitrust amount for any such year shall also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (b) above to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as [*same percentage as in (b) above*] percent of the net fair market value of the Trust assets on the valuation dates.

7. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the unitrust amount

to the Recipients, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

8. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

9. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____. The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(2) and (3) of the Code and the corresponding regulations.

10. *Limited Power of Amendment.* The Trust is irrevocable. The Trustee, however, shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of section 664(d)(2) and (3) of the Code.

11. *Investment of Trust Assets.* Nothing in this Trust instrument shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 7. SAMPLE TESTAMENTARY CHARITABLE REMAINDER UNITRUST: ONE LIFE

All the rest, residue, and remainder of my property and estate, real and personal, of whatever nature and wherever situated, [*Alternatively, if not a residuary bequest, describe or identify the bequest.*] I give, devise, and bequeath to my Trustee in trust. It being my intention to establish a charitable remainder unitrust within the meaning of section 7 of Rev. Proc. 90-31 and section 664(d)(2) and (3) of the Internal Revenue Code (hereinafter referred to as "the Code"), such Trust shall be known as the _____ Charitable Remainder Unitrust and I hereby designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Payment of Unitrust Amount.* In each taxable year of the Trust, the Trustee shall pay to [*a living individual*] (hereinafter referred to as "the Recipient") during the Recipient's life a unitrust amount equal to the lesser of: (a) the Trust income for the taxable year, as defined in section 643(b) of the Code and the regulations thereunder, and (b) [*at least 5*] percent of the net fair market value of the assets of the Trust valued as of the first day of each taxable year of the Trust (the "valuation date"). The unitrust amount for any year shall also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (b) (above) to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as [*same percentage as in (b) above*] percent of the net fair market value of the Trust assets on the valuation dates.

The unitrust amount shall be paid in quarterly installments. Any income of the Trust for a taxable year in excess of the unitrust amount shall be added to principal. If for any year the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipient (in the case of an undervaluation) or receive from the Recipient (in the case of an overvaluation) an amount equal to the difference between the unitrust amount properly payable and the unitrust amount actually paid.

2. *Deferral Provision.* The obligation to pay the unitrust amount shall commence with the date of my death, but payment of the unitrust amount may be deferred from such date until the end of the taxable year of the Trust in which occurs the complete funding of the Trust. Within a reasonable time after the end of the taxable year in which the complete funding of the Trust occurs, the Trustee must pay to the Recipient (in the case of an underpayment) or receive from the Recipient (in the case of an overpayment) the difference between: (1) any unitrust amounts actually paid, plus interest compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 of the Code prescribe for the Trust for such computation for such period; and (2) the unitrust amounts payable, plus interest compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 prescribe for the Trust for such computation for such period.

3. *Proration of the Unitrust Amount.* In determining the unitrust amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the Recipient's death.

4. *Distribution to Charity.* Upon the death of the Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due the Recipient or the Recipient's estate under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c) and 2055(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c) and 2055(a) as the Trustee shall select in its sole discretion.

5. *Additional Contributions.* No additional contributions shall be made to the Trust after the initial contribution. The initial contribution, however, shall be deemed to consist of all property passing to the Trust by reason of my death.

6. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the unitrust amount to the Recipient, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations

thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

7. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

8. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____. The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(2) and (3) of the Code and the corresponding regulations.

9. *Limited Power of Amendment.* The Trustee shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of section 664(d)(2) and (3) of the Code.

10. *Investment of Trust Assets.* Nothing herein shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 8. SAMPLE TESTAMENTARY CHARITABLE REMAINDER UNITRUST: TWO LIVES, CONSECUTIVE INTERESTS

All the rest, residue, and remainder of my property and estate, real and personal, of whatever nature and wherever situated, [*Alternatively, if not a residuary bequest, describe or identify the bequest.*] I give, devise, and bequeath to my Trustee in trust. It being my intention to establish a charitable remainder unitrust within the meaning of section 8 of Rev. Proc. 90-31 and section 664(d)(2) and (3) of the Internal Revenue Code (hereinafter referred to as "the Code"), such Trust shall be known as the _____ Charitable Remainder Unitrust and I hereby designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Payment of Unitrust Amount.* In each taxable year of the Trust, the Trustee shall pay to [*a living individual*] during his or her lifetime, and after his or her death, to [*a living individual*] (hereinafter referred to as "the Recipients"), for such time as he or she survives, a unitrust amount equal to the lesser of: (a) the Trust income for the taxable year, as defined in section 643(b) of the Code and the regulations thereunder, and (b) [*at least 5*] percent of the net fair market value of the assets of the Trust valued as of the first day of each taxable year of the Trust (the "valuation date"). The unitrust amount for any year shall also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (b) (above) to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as [*same percentage as in (b) above*] percent of the net fair market value of the Trust assets on the valuation dates.

The unitrust amount shall be paid in quarterly installments. Any income of the Trust for a taxable year in excess of the unitrust amount shall be added to principal. If for any year the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the unitrust amount properly payable and the unitrust amount actually paid.

2. *Deferral Provision.* The obligation to pay the unitrust amount shall commence with the date of my death, but payment of the unitrust amount may be deferred from such date until the end of the taxable year of the Trust in which occurs the complete funding of the Trust. Within a reasonable time after the end of the taxable year in which the complete funding of the Trust occurs, the Trustee must pay to the Recipients (in the case of an underpayment) or receive from the Recipients (in the case of an overpayment) the difference between: (1) any unitrust amounts actually paid, plus interest compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 of Code prescribe for the trust for such computation for such period; and (2) the unitrust amounts payable, plus interest compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 of Code prescribe for the Trust for such computation for such period.

3. *Proration of the Unitrust Amount.* In determining the unitrust amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the survivor Recipient's death.

4. *Distribution to Charity.* Upon the death of the survivor Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due either of the Recipients or their estates under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c) and 2055(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c) and 2055(a) as the Trustee shall select in its sole discretion.

5. *Additional Contributions.* No additional contributions shall be made to the Trust after the initial contribution. The initial contribution, however, shall be deemed to consist of all property passing to the Trust by reason of my death.

6. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the unitrust amount to the Recipients, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

7. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

8. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____. The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(2) and (3) of the Code and the corresponding regulations.

9. *Limited Power of Amendment.* The Trustee shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of section 664(d)(2) and (3) of the Code.

10. *Investment of Trust Assets.* Nothing herein shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 9. SAMPLE TESTAMENTARY CHARITABLE REMAINDER UNITRUST: TWO LIVES, CONCURRENT AND CONSECUTIVE INTERESTS

All the rest, residue, and remainder of my property and estate, real and personal, of whatever nature and wherever situated, [*Alternatively, if not a residuary bequest, describe or identify the bequest.*] I give, devise, and bequeath to my Trustee in trust. It being my intention to establish a charitable remainder unitrust within the meaning of section 9 of Rev. Proc. 90-31 and section 664(d)(2) and (3) of the Internal Revenue Code (hereinafter referred to as "the Code"), such Trust shall be known as the _____ Charitable Remainder Unitrust and I hereby designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Payment of Unitrust Amount.* In each taxable year of the Trust, the Trustee shall pay to [*a living individual*] and [*a living individual*] (hereinafter referred to as "the Recipients"), in equal shares during their lifetimes, a unitrust amount equal to the lesser of: (a) the Trust income for the taxable year, as defined in section 643(b) of the Code and the regulations thereunder, and (b) [*at least 5*] percent of the net fair market value of the assets of the Trust valued as of the first day of each taxable year of the Trust (the "valuation date"). The unitrust amount for any year shall also include any amount of Trust income for such year that is in excess of the amount required to be distributed under (b) (above) to the extent that the aggregate of the amounts paid in prior years was less than the aggregate of the amounts computed as [*same percentage as in (b) above*] percent of the net fair market value of the trust assets on the valuation dates.

Upon the death of the first of the Recipients to die, the survivor Recipient shall be entitled to receive the entire unitrust amount. The unitrust amount shall be paid in quarterly installments. Any income of the Trust for a taxable year in excess of the unitrust amount and which is not paid pursuant to the second preceding sentence shall be added to principal. If for any year the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the unitrust amount properly payable and the unitrust amount actually paid.

2. *Deferral Provision.* The obligation to pay the unitrust amount shall commence with the date of my death, but payment of the unitrust amount may be deferred from such date until the end of the taxable year of the Trust in which occurs the complete funding of the Trust. Within a reasonable time after the end of the taxable year in which the complete funding of the Trust occurs, the Trustee must pay to the Recipients (in the case of an underpayment) or receive from the Recipients (in the case of an overpayment) the difference between: (1) any unitrust amounts actually paid, plus interest compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 of the Code prescribe for the Trust for such computation for such period; and (2) the unitrust amounts payable, plus interest compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 of the Code prescribe for the Trust for such computation for such period.

3. *Proration of the Unitrust Amount.* In determining the unitrust amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the survivor Recipient's death.

4. *Distribution to Charity.* Upon the death of the survivor Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due either of the Recipients or their estates under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c) and 2055(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c) and 2055(a) as the Trustee shall select in its sole discretion.

5. *Additional Contributions.* No additional contributions shall be made to the Trust after the initial contribution. The initial contribution, however, shall be deemed to consist of all property passing to the Trust by reason of my death.

6. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the unitrust amount to the Recipients, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

7. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

8. *Governing Law.* The operation of the Trust shall be governed by the

laws of the State of _____. The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(2) and (3) of the Code and the corresponding regulations.

9. *Limited Power of Amendment.* The Trustee shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder unitrust within the meaning of section 664(d)(2) and (3) of the Code.

10. *Investment of Trust Assets.* Nothing herein shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 10. EFFECTIVE DATE

This revenue procedure is effective on and after June 18, 1990, the date of publication of this revenue procedure in the Internal Revenue Bulletin.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 170, 664, 2055, 2522; 1.170A-6, 1.664-2, 20.2055-2, 25.2522(c)-3.)

Rev. Proc. 90-32

SECTION 1. PURPOSE

This revenue procedure makes available five sample forms of trust that meet the requirements for a charitable remainder annuity trust as described in section 664(d)(1) of the Internal Revenue Code.

SEC. 2. BACKGROUND

The Internal Revenue Service receives and responds to requests for rulings dealing with the qualification of trusts as charitable remainder trusts and the availability of deductions for contributions made to such trusts. In many of these requests, the trust instruments and charitable objectives are very similar. Consequently, in order to provide a service to taxpayers and to save the time and expense involved in requesting and processing a ruling on a proposed charitable remainder annuity trust, this revenue procedure allows taxpayers who make transfers to a trust that substantially follows one of the sample forms of trust contained herein to be assured that the Service will recognize the trust as meeting all of the requirements of a charitable remainder annuity trust, provided that the trust operates in a manner consistent with the terms of the instrument creating the trust and provided it is a valid trust under applicable local law.

SEC. 3. SCOPE AND OBJECTIVE

Section 4 of Rev. Proc. 89-21, 1989-1 C.B. 842, provides a sample form of trust for an inter vivos charitable remainder annuity trust providing for annuity payments during one life that meets all of the applicable requirements of section 664(d)(1) of the Code. This revenue procedure amplifies Rev. Proc. 89-21 by providing the following additional sample forms of trust.

Sec. 4—Sample Inter Vivos Charitable Remainder Annuity Trust: Two Lives, Consecutive Interests;

Sec. 5—Sample Inter Vivos Charitable Remainder Annuity Trust: Two Lives, Concurrent and Consecutive Interests;

Sec. 6—Sample Testamentary Charitable Remainder Annuity Trust: One Life;

Sec. 7—Sample Testamentary Charitable Remainder Annuity Trust: Two Lives, Consecutive Interests; and

Sec. 8—Sample Testamentary Charitable Remainder Annuity Trust: Two Lives, Concurrent and Consecutive Interests.

In all cases, the termination of the life interests must be followed by a distribution of the trust assets to the charitable remainder beneficiary, and the trust must be a valid trust under applicable local law.

If the trust provisions are substantially similar to those in one of the samples provided in sections 4 through 8 of this revenue procedure or in section 4 of Rev. Proc. 89-21, the Service will recognize the trust as satisfying all of the applicable requirements of section 664(d)(1) of the Code and the corresponding regulations. A document will be considered to be substantially similar to one of the samples even though, for example, the wording is varied to comport with local law and practice as necessary to create trusts, define legal relationships, pass property by bequest, provide for the appointment of alternative and successor trustees, or designate alternative charitable remaindermen. Moreover, for transfers to a qualifying charitable remainder annuity trust, the remainder interest will be deductible under sections 170(f)(2)(A), 2055(e)(2)(A), and 2522(c)(2)(A) for income, estate, and gift tax purposes, respectively, if the charitable remainder beneficiary otherwise meets all of the requirements of those provisions. Therefore, it will not be necessary for a taxpayer to request a ruling on the qualification of a substantially similar trust. A trust that contains substantive provisions in addition to those provided by sections 4 through 8 of this revenue procedure or by section 4 of Rev. Proc. 89-21 (other than provisions necessary to establish a valid trust under applicable local law) or that omits any of these provisions will not necessarily be disqualified, but it will not be assured of qualification under the provisions of this revenue procedure.

SEC. 4. SAMPLE INTER VIVOS CHARITABLE REMAINDER ANNUITY TRUST: TWO LIVES, CONSECUTIVE INTERESTS

On this _____ day of _____, 19__, I, _____ (hereinafter referred to as "the Donor"), desiring to establish a charitable remainder annuity trust, within the meaning of section 4 of Rev. Proc. 90-32 and section 664(d)(1) of the Internal Revenue Code (hereinafter referred to as "the Code") hereby create the _____ Charitable Remainder Annuity Trust and designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Funding of Trust.* The Donor transfers to the Trustee the property described in Schedule A, and the Trustee accepts such property and agrees to hold, manage, and distrib-

ute such property of the Trust under the terms set forth in this Trust instrument.

2. *Payment of Annuity Amount.* In each taxable year of the Trust, the Trustee shall pay to [a living individual] during his or her lifetime and, after his or her death, to [a living individual] (hereinafter referred to as "the Recipients"), for such time as he or she survives, an annuity amount equal to [*at least 5*] percent of the net fair market value of the assets of the Trust as of the date of this Trust. The annuity amount shall be paid in equal quarterly amounts from income and, to the extent that income is not sufficient, from principal. Any income of the Trust for a taxable year in excess of the annuity amount shall be added to principal. If the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

3. *Payment of Federal Estate Taxes and State Death Taxes.* The lifetime annuity interest of the second Recipient will take effect upon the death of the first Recipient only if the second Recipient furnishes the funds for payment of any federal estate taxes or state death taxes for which the Trustee may be liable upon the death of the first Recipient. [*This provision is mandatory only if all or a portion of the trust may be subject to such taxes on the death of the first recipient.*]

4. *Proration of the Annuity Amount.* In determining the annuity amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the survivor Recipient's death.

5. *Distribution to Charity.* Upon the death of the survivor Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due either of the Recipients or their estates under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c), 2055(a), and 2522(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c), 2055(a), and 2522(a) as the Trustee shall select in its sole discretion.

6. *Additional Contributions.* No additional contributions shall be made to the Trust after the initial contribution.

7. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the annuity amount to the Recipients, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

8. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

9. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____. The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(1) of the Code and the corresponding regulations.

10. *Limited Power of Amendment.* The Trust is irrevocable. The Trustee, however, shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder annuity trust within the meaning of section 664(d)(1) of the Code.

11. *Investment of Trust Assets.* Nothing in this Trust instrument shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 5. SAMPLE INTER VIVOS CHARITABLE REMAINDER ANNUITY TRUST: TWO LIVES, CONCURRENT AND CONSECUTIVE INTERESTS

On this _____ day of _____, 19__, I, _____ (hereinafter referred to as "the Donor"), desiring to establish a charitable remainder annuity trust, within the meaning of section 5 of Rev. Proc. 90-32 and section 664(d)(1) of the Internal Revenue Code (hereinafter referred to as "the Code") hereby create the _____ Charitable Remainder Annuity Trust and designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Funding of Trust.* The Donor transfers to the Trustee the property described in Schedule A, and the Trustee accepts such property and agrees to hold, manage, and distribute such property of the Trust under the terms set forth in this Trust instrument.

2. *Payment of Annuity Amount.* In each taxable year of the Trust, the Trustee shall pay to [a living individual] and [a living individual] (hereinafter referred to as "the Recipients"), in equal shares during their lifetimes, an annuity amount equal to [*at least 5*] percent of the net fair market value of the assets of the Trust as of the date of this Trust. Upon the death of the first of the Recipients to die, the survivor Recipient shall be entitled to receive the entire annuity amount. The annuity amount shall be paid in equal quarterly amounts from income and, to the extent that income is not sufficient, from principal. Any income of the Trust for a taxable year in excess of the annuity amount shall be added to principal. If the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the

annuity amount(s) properly payable and the annuity amount(s) actually paid.

3. *Payment of Federal Estate Taxes and State Death Taxes.* The lifetime annuity interest of the survivor Recipient will continue in effect upon the death of the first Recipient to die only if the survivor Recipient furnishes the funds for payment of any federal estate taxes or state death taxes for which the Trustee may be liable upon the death of the first Recipient to die. [*This provision is mandatory only if all or a portion of the trust may be subject to such taxes on the death of the first recipient to die.*]

4. *Proration of the Annuity Amount.* In determining the annuity amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the survivor Recipient's death.

5. *Distribution to Charity.* Upon the death of the survivor Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due either of the Recipients or their estates under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c), 2055(a), and 2522(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c), 2055(a), and 2522(a) as the Trustee shall select in its sole discretion.

6. *Additional Contributions.* No additional contributions shall be made to the Trust after the initial contribution.

7. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the annuity amount to the Recipients, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

8. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

9. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____. The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(1) of the Code and the corresponding regulations.

10. *Limited Power of Amendment.* The Trust is irrevocable. The Trustee, however, shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder annuity trust within the meaning of section 664(d)(1) of the Code.

11. *Investment of Trust Assets.* Nothing in this Trust instrument shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 6. SAMPLE TESTAMENTARY CHARITABLE REMAINDER ANNUITY TRUST: ONE LIFE

All the rest, residue and remainder of my property and estate, real and personal, of whatever nature and wherever situated, [*Alternatively, if not a residuary bequest, describe or identify the bequest.*] I give, devise and bequeath to my Trustee in trust. It being my intention to establish a charitable remainder annuity trust within the meaning of section 6 of Rev. Proc. 90-32 and section 664(d)(1) of the Internal Revenue Code (hereinafter referred to as "the Code"), such Trust shall be known as the _____ Charitable Remainder Annuity Trust and I hereby designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Payment of Annuity Amount.* In each taxable year of the Trust, the Trustee shall pay to [a living individual] (hereinafter referred to as "the Recipient") during the Recipient's life an annuity amount equal to [*at least 5*] percent of the initial net fair market value of the assets passing in trust as finally determined for federal tax purposes, provided, however, that the payout percentage (as adjusted to reflect the timing and frequency of the annuity payments) shall not exceed the percentage that would result in a 5 percent probability that the Trust corpus will be exhausted before the death of the Recipient determined as of the date of my death (or the alternate valuation date, if applicable). [*Note: The preceding sentence is one means of avoiding disallowance of the charitable deduction with respect to a charitable remainder annuity trust for which there is a greater than 5 percent probability that the trust corpus will be exhausted before the death of the annuitant. See Rev. Rul. 77-374, 1977-2 C.B. 329.*] The annuity amount shall be paid in equal quarterly amounts from income and, to the extent that income is not sufficient, from principal. Any income of the Trust for a taxable year in excess of the annuity amount shall be added to principal. If the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipient (in the case of an undervaluation) or receive from the Recipient (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

2. *Deferral Provision.* The obligation to pay the annuity amount shall commence with the date of my death, but payment of the annuity amount may be deferred from such date until the end of the taxable year of the Trust in which occurs the complete funding of the Trust. Within a reasonable time after the end of the taxable year in which the complete funding of the Trust occurs, the Trustee must pay to the Recipient (in the case of an underpayment) or receive from the Recipient (in the case of an overpayment) the difference between: (1) any annuity amounts actually paid, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under

section 664 of the Code prescribe for the Trust for such computation for such period; and (2) the annuity amounts payable, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 prescribe for the Trust for such computation for such period.

3. *Proration of the Annuity Amount.* In determining the annuity amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the Recipient's death.

4. *Distribution to Charity.* Upon the death of the Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due the Recipient or the Recipient's estate under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c) and 2055(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c) and 2055(a) as the Trustee shall select in its sole discretion.

5. *Additional Contributions.* No additional contributions shall be made to the Trust after the initial contribution. The initial contribution, however, shall be deemed to consist of all property passing to the Trust by reason of my death.

6. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the annuity amount to the Recipient, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

7. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

8. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____. The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(1) of the Code and the corresponding regulations.

9. *Limited Power of Amendment.* The Trustee shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder annuity trust within the meaning of section 664(d)(1) of the Code.

10. *Investment of Trust Assets.* Nothing herein shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 7. SAMPLE TESTAMENTARY CHARITABLE REMAINDER ANNUITY TRUST: TWO LIVES, CONSECUTIVE INTERESTS

All the rest, residue and remainder of my property and estate, real and personal, of whatever nature and wherever situated, [*Alternatively, if not a residuary bequest, describe or identify the bequest.*] I give, devise and bequeath to my Trustee in trust. It being my intention to establish a charitable remainder annuity trust within the meaning of section 7 of Rev. Proc. 90-32 and section 664(d)(1) of the Internal Revenue Code (hereinafter referred to as "the Code"), such Trust shall be known as the _____ Charitable Remainder Annuity Trust and I hereby designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Payment of Annuity Amount.* In each taxable year of the Trust, the Trustee shall pay to [a living individual] during his or her lifetime, and after his or her death, to [a living individual] (hereinafter referred to as "the Recipients"), for such time as he or she survives, an annuity amount equal to [*at least 5*] percent of the initial net fair market value of the assets passing in trust as finally determined for federal tax purposes, provided, however, that the payout percentage (as adjusted to reflect the timing and frequency of the annuity payments) shall not exceed the percentage that would result in a 5 percent probability that the Trust corpus will be exhausted before the death of the survivor Recipient determined as of the date of my death (or the alternate valuation date, if applicable). [*Note: The preceding sentence is one means of avoiding disallowance of the charitable deduction with respect to a charitable remainder annuity trust for which there is a greater than 5 percent probability that the trust corpus will be exhausted before the death of the annuitant. See Rev. Rul. 77-374, 1977-2 C.B. 329.*] The annuity amount shall be paid in equal quarterly amounts from income and, to the extent that income is not sufficient, from principal. Any income of the Trust for a taxable year in excess of the annuity amount shall be added to principal. If the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

2. *Deferral Provision.* The obligation to pay the annuity amount shall commence with the date my death, but payment of the annuity amount may be deferred from such date until the end of the taxable year of the Trust in which occurs the complete funding of the Trust. Within a reasonable time after the end of the taxable year in which the complete funding of the Trust occurs, the Trustee must pay to the Recipients (in the case of an underpayment) or receive from the Recipients (in the case of an overpayment) the difference between: (1) any annuity amounts actually paid, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 of the Code prescribe for the Trust for such computation for such period; and (2) the annuity amounts payable, plus interest, com-

pounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 prescribe for the Trust for such computation for such period.

3. *Proration of the Annuity Amount.* In determining the annuity amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the survivor Recipient's death.

4. *Distribution to Charity.* Upon the death of the survivor Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due either of the Recipients or their estates, under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c)and 2055(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c) and 2055(a) as the Trustee shall select in its sole discretion.

5. *Additional Contributions.* No additional contributions shall be made to the Trust after the initial contribution. The initial contribution, however, shall be deemed to consist of all property passing to the Trust by reason of my death.

6. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the annuity amount to the Recipients, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

7. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

8. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____.

The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(1) of the Code and the corresponding regulations.

9. *Limited Power of Amendment.* The Trustee shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder annuity trust within the meaning of section 664(d)(1) of the Code.

10. *Investment of Trust Assets.* Nothing herein shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 8. SAMPLE TESTAMENTARY CHARITABLE REMAINDER ANNUITY TRUST: TWO LIVES, CONCURRENT AND CONSECUTIVE INTERESTS

All the rest, residue and remainder of my property and estate, real and personal, of whatever nature and wherever situated, [*Alternatively, if not a residuary bequest, describe or identify the bequest.*] I give, devise and bequeath to my Trustee in trust. It being my intention to establish a charitable remainder annuity trust within the meaning of section 8 of Rev. Proc. 90-32 and section 664(d)(1) of the Internal Revenue Code (hereinafter referred to as "the Code"), such Trust shall be known as the _____ Charitable Remainder Annuity Trust and I hereby designate _____ as the initial Trustee. [*Alternate or successor trustees may also be designated if desired.*]

1. *Payment of Annuity Amount.* In each taxable year of the Trust, the Trustee shall pay to _____[a living individual] and _____[a living individual] (hereinafter referred to as "the Recipients"), in equal shares during their lifetimes, an annuity amount equal to [at least 5] percent of the initial net fair market value of the assets passing in trust as finally determined for federal tax purposes, provided, however, that the payout percentage (as adjusted to reflect the timing and frequency of the annuity payments) shall not exceed the percentage that would result in a 5 percent probability that the Trust corpus will be exhausted before the death of the survivor Recipient determined as of the date of my death (or the alternate valuation date, if applicable). [*Note: The preceding sentence is one means of avoiding disallowance of the charitable deduction with respect to a charitable remainder annuity trust for which there is a greater than 5 percent probability that the trust corpus will be exhausted before the death of the annuitant. See Rev. Rul. 77-374, 1977-2 C.B. 329.*] Upon the death of the first of the Recipients to die, the survivor Recipient shall be entitled to receive the entire annuity amount. The annuity amount shall be paid in equal quarterly amounts from income and, to the extent that income is not sufficient, from principal. Any income of the Trust for a taxable year in excess of the annuity amount shall be added to principal. If the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the Recipients (in the case of an undervaluation) or receive from the Recipients (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

2. *Deferral Provision.* The obligation to pay the annuity amount shall commence with the date of my death, but payment of the annuity amount may be deferred from such date until the end of the taxable year of the Trust in which occurs the complete funding of the Trust. Within a reasonable time after the end of the taxable year in which the complete funding of the Trust occurs, the Trustee must pay to the Recipients (in the case of an underpayment) or receive from the Recipients (in the case of an overpayment) the difference between: (1) any annuity amounts actually paid, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 of the Code prescribe for the Trust for such computation for such period; and (2) the annuity

amounts payable, plus interest, compounded annually, computed for any period at the rate of interest that the federal income tax regulations under section 664 prescribe for the Trust for such computation for such period.

3. *Proration of the Annuity Amount.* In determining the annuity amount, the Trustee shall prorate the same on a daily basis for a short taxable year and for the taxable year ending with the survivor Recipient's death.

4. *Distribution to Charity.* Upon the death of the survivor Recipient, the Trustee shall distribute all of the then principal and income of the Trust (other than any amount due either of the Recipients or their estates under the provisions above) to _____ (hereinafter referred to as "the Charitable Organization"). If the Charitable Organization is not an organization described in sections 170(c) and 2055(a) of the Code at the time when any principal or income of the Trust is to be distributed to it, then the Trustee shall distribute such principal or income to such one or more organizations described in sections 170(c) and 2055(a) as the Trustee shall select in its sole discretion.

5. *Additional Contributions.* No additional contributions shall be made to the Trust after the initial contribution. The initial contribution, however, shall be deemed to consist of all property passing to the Trust by reason of my death.

6. *Prohibited Transactions.* The Trustee shall make distributions at such time and in such manner as not to subject the Trust to tax under section 4942 of the Code. Except for the payment of the annuity amount to the Recipients, the Trustee shall not engage in any act of self-dealing, as defined in section 4941(d), and shall not make any taxable expenditures, as defined in section 4945(d). The Trustee shall not make any investments that jeopardize the charitable purpose of the Trust, within the meaning of section 4944 and the regulations thereunder, or retain any excess business holdings, within the meaning of section 4943(c).

7. *Taxable Year.* The taxable year of the Trust shall be the calendar year.

8. *Governing Law.* The operation of the Trust shall be governed by the laws of the State of _____. The Trustee, however, is prohibited from exercising any power or discretion granted under said laws that would be inconsistent with the qualification of the Trust under section 664(d)(1) of the Code and the corresponding regulations.

9. *Limited Power of Amendment.* The Trustee shall have the power, acting alone, to amend the Trust in any manner required for the sole purpose of ensuring that the Trust qualifies and continues to qualify as a charitable remainder annuity trust within the meaning of section 664(d)(1) of the Code.

10. *Investment of Trust Assets.* Nothing herein shall be construed to restrict the Trustee from investing the Trust assets in a manner that could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of Trust assets.

SEC. 9. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 89-21 is amplified.

SEC. 10. EFFECTIVE DATE

This revenue procedure is effective on and after June 18, 1990, the date of publication of this revenue procedure in the Internal Revenue Bulletin.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 170, 664, 2055, 2522; 1.170A-6, 1.664-2, 1.664-3, 20.2055-2, 25.2522(c)-3.)

Rev. Proc. 90-33

SECTION 1. BACKGROUND

Rev. Proc. 90-32, page 546, this Bulletin, makes available five sample declarations of trust that meet the applicable requirements under section 664(d)(1) of the Internal Revenue Code for inter vivos and testamentary charitable remainder annuity trusts providing respectively for annuity payments during one life, during two lives where the interests are consecutive, and during two lives where the interests are concurrent and consecutive.

Rev. Proc. 90-30, page 534, this Bulletin, makes available five sample declarations of trust that meet the applicable requirements under section 664(d)(2) of the Code for inter vivos and testamentary charitable remainder unitrusts providing respectively for unitrust payments during one life, during two lives where the interests are consecutive, and during two lives where the interests are concurrent and consecutive.

Rev. Proc. 90-31, page 539, this Bulletin, makes available six sample declarations of trust that meet the applicable requirements under section 664(d)(2) and (3) of the Code for inter vivos and testamentary income exception charitable remainder unitrusts providing respectively for unitrust payments during one life, during two lives where the interests are consecutive, and during two lives where the interests are concurrent and consecutive.

Rev. Proc. 90-3, page 402, this Bulletin, sets forth areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Technical) in which the Internal Revenue Service will not issue advance rulings or determination letters. Section 4 of Rev. Proc. 90-3 lists areas in which rulings or determination letters will not ordinarily be issued.

SEC. 2. PROCEDURE

Rev. Proc. 90-3 is amplified by adding to section 4 the following:

Section 170—Charitable, Etc. Contributions and Gifts.—Whether a transfer to a charitable remainder trust described in section 664 of the Code that provides for annuity or unitrust payments for one or two measuring lives qualifies for a charitable deduction under section 170(f)(2)(A).

Section 664—Charitable Remainder Trusts.—Whether a charitable remainder trust that provides for annuity or unitrust payments for one or two measuring lives satisfies the requirements described in section 664 of the Code.

Section 2055—Transfers for Public, Charitable and Religious Uses.—Whether a transfer to a charitable remainder trust described in section 664 of the Code that provides for annuity or unitrust payments for one or two measuring lives qualifies for a charitable deduction under section 2055(e)(2)(A).

Section 2522—Charitable and Similar Gifts.—Whether a transfer to a charitable remainder trust described

in section 664 of the Code that provides for annuity or unitrust payments for one or two measuring lives qualifies for a charitable deduction under section 2522(c)(2)(A).

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests received in the National Office after June 18, 1990, the date of publication of this revenue procedure.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 90-3 is amplified.

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, Sections 62, 162, 274; 1.62-2T, 1.162-17, 1.274-5T.)

Rev. Proc. 90-34

SECTION 1. PURPOSE

This revenue procedure amplifies Rev. Proc. 89-66, 1989-2 C.B. 792, by providing an additional method under which the amount of ordinary and necessary expenses paid or incurred by an employee in driving an automobile in connection with the performance of services as an employee of the employer will be deemed substantiated under section 1.274-5T of the temporary Income Tax Regulations when a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance arrangement to pay for such expenses.

SEC. 2. PROCEDURE

Rev. Proc. 89-66 is hereby amplified by modifying existing section 3.03, adding new sections 3.04 and 7, and modifying and renumbering existing sections 7 and 8 as sections 8 and 9, as follows:

SEC. 3. DEFINITIONS

* * * * *

.03 *Mileage allowance.* The term "mileage allowance" means a payment under a reimbursement or other expense allowance arrangement that meets the requirements specified in section 1.62-2T(c)(1) of the temporary regulations and that

* * * * *

(3) is paid at the applicable standard mileage rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.04 *Flat rate or stated schedule.* A mileage allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 3.03 above. Such allowance may be paid periodically at a fixed rate, at a cents-per-mile rate, at a variable rate based on a stated schedule, at a rate that combines any of these rates, or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, a periodic payment at a fixed rate to cover the fixed costs (including depreciation, insurance, registration and license fees, and personal property taxes) of driving an automobile in connection with the performance of services as an employee of the employer, coupled with a periodic payment at a cents-per-mile rate to cover the operating costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of using an automobile for such purposes, is an allowance paid at a flat rate or stated schedule. Likewise, a periodic payment at a variable rate based on a stated schedule for different locales to cover the costs of driving an automobile in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

* * * * *

SEC. 7. FIXED AND VARIABLE RATE ALLOWANCE

.01 General rules.

(1) This section provides rules under which the ordinary and necessary expenses paid or incurred by an employee in driving an automobile in connection with the performance of services as an employee of the employer will be deemed substantiated (in an amount determined under section 8 below) when a payor reimburses such expenses with a mileage allowance using a flat rate or stated schedule that combines periodic fixed and variable rate payments that meet all the requirements in this section 7 (a FAVR allowance).

(2) The amount of a FAVR allowance must be based on data that (a) is derived from the base locality, (b) reflects retail prices paid by consumers, and (c) is reasonable and statistically defensible in approximating the actual expenses of employees receiving the allowance.

.02 *Definitions.*

(1) *FAVR allowance.* A FAVR allowance includes periodic fixed payments and periodic variable payments. A payor may maintain more than one FAVR allowance. A FAVR allowance that uses the same payor, standard automobile (or an automobile of the same make and model that is comparably equipped), retention period, and business use percentage is considered one FAVR allowance, even though other features of the allowance may vary. A FAVR allowance also includes any optional high mileage payments; however, such optional high mileage payments are included in the employee's gross income and are subject to the reporting and employment tax withholding and payment rules. See section 8 below. An optional high mileage payment covers the additional depreciation for a standard automobile attributable to business miles driven and substantiated by the employee for a calendar year in excess of the annual business mileage for that year. If an employee is covered by the FAVR allowance for less than the entire calendar year, the annual business mileage may be prorated on a monthly basis for purposes of the preceding sentence.

(2) *Periodic fixed payment.* A periodic fixed payment covers the projected fixed costs (including depreciation, insurance, registration and license fees, and personal property taxes) of driving a standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. A periodic fixed payment may be computed by (a) dividing the total projected fixed costs for the standard automobile for all years of the retention period, determined at the beginning of the retention period, by the number of periodic fixed payments in the retention period, and (b) multiplying the resulting amount by the business use percentage.

(3) *Periodic variable payment.* A periodic variable payment covers the projected operating costs (including

gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of driving a standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. The rate of a periodic variable payment for a computation period may be computed by dividing the total projected operating costs for the standard automobile for the computation period, determined at the beginning of the computation period, by the computation period mileage. A computation period can be any period of a year or less. Computation period mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a computation period and equals the retention mileage divided by the number of computation periods in the retention period. For each business mile substantiated by the employee for the computation period, the periodic variable payment must be paid at a rate that does not exceed the rate for that computation period.

(4) *Base locality.* A base locality is the particular geographic locality or region of the United States in which the costs of driving an automobile in connection with the performance of services as an employee of the employer are generally paid or incurred by the employee. Thus, for purposes of determining the amount of fixed costs, the base locality is generally the geographic locality or region in which the employee resides. For purposes of determining the amount of operating costs, the base locality is generally the geographic locality or region in which the employee drives the automobile in connection with the performance of services as an employee of the employer.

(5) *Standard automobile.* A standard automobile is the automobile selected by the payor on which a specific FAVR allowance is based.

(6) *Standard automobile cost.* The standard automobile cost for a calendar year may not exceed 95 percent of the sum of (a) the retail dealer invoice cost of the standard automobile in the base locality, and (b) state and local sales or use taxes applicable on the purchase of such an automobile. Further, the standard automobile cost may not exceed $22,500.

(7) *Annual mileage.* Annual mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a calendar year. Annual mileage equals the annual business mileage divided by the business use percentage.

(8) *Annual business mileage.* Annual business mileage is the mileage a payor reasonably projects a standard automobile will be driven by an employee in connection with the performance of services as an employee of the employer during the calendar year, but may not be less than 6,250 miles for a calendar year. Annual business mileage equals the annual mileage multiplied by the business use percentage.

(9) *Business use percentage.* A business use percentage is determined by dividing the annual business mileage by the annual mileage. The business use percentage may not exceed 75 percent. In lieu of demonstrating the reasonableness of the business use percentage based on records of total mileage and business mileage driven by the employees annually, a payor may use a business use percentage that is less than or equal to the following percentages for a FAVR allowance that is paid for the following annual business mileage:

Annual business mileage	*Business use percentage*
6,250 or more but less than 10,000	45%
10,000 or more but less than 15,000	55%
15,000 or more but less than 20,000	65%
20,000 or more	75%

(10) *Retention period.* A retention period is the period in calendar years selected by the payor during which the payor expects an employee to drive a standard automobile in connection with the performance of services as an employee of the employer before the automobile is replaced. Such period may not be less than two calendar years.

(11) *Retention mileage.* Retention mileage is the annual mileage multiplied by the number of calendar years in the retention period.

(12) *Residual value.* The residual value of a standard automobile is the projected amount for which it could be sold at the end of the retention period after being driven the retention mileage. The Service will accept the following safe harbor residual values for a standard automobile computed as a percentage of the standard automobile cost:

Retention period	*Residual value*
2-year	70 percent
3-year	60 percent
4-year	50 percent

.03 *FAVR allowance in lieu of operating and fixed costs.*

(1) Except as provided in section 7.03(2) below, a deduction computed using a FAVR allowance is in lieu of all the operating and fixed costs paid or incurred by an employee in driving the automobile in connection with the performance of services as an employee of the employer.

(2) Parking fees and tolls attributable to an employee driving the standard automobile in connection with the performance of services as an employee of the employer are not included in fixed and operating costs and may be deducted as separate items. Similarly, interest relating to the purchase of the standard automobile may be deducted as a separate item but only to the extent that the interest is deductible under section 163 of the Code.

.04 *Depreciation.*

(1) A FAVR allowance may not be paid with respect to an automobile for which the employee has claimed (a) depreciation using a method other than straight-line for its estimated useful life, (b) additional first-year depreciation, or (c) depreciation using the Accelerated Cost Recovery System (ACRS) under section 168 of the Code. If an employee uses actual costs for an automobile that has been covered by a FAVR allowance, the employee must use straight-line depreciation for the automobile's estimated useful life (subject to the applicable depreciation deduction limitations under section 280F for any passenger automobile).

(2) The total amount of the depreciation component for the retention period taken into account in computing the periodic fixed payments for that retention period may not exceed the excess of the standard automobile cost over the residual value of the standard automobile. In addition, the total amount of such depreciation component may not ex-

ceed the sum of the annual section 280F limitations on depreciation (in effect at the beginning of the retention period) that apply to the standard automobile during the retention period.

(3) The depreciation included in each periodic fixed payment portion of a FAVR allowance paid with respect to an automobile will reduce the basis of the automobile (but not below zero) in determining adjusted basis as required by section 1016 of the Code. See section 7.07(2) below for the requirement that the employer report the depreciation component of a periodic fixed payment to the employee.

.05 *FAVR allowance limitations.*

(1) A FAVR allowance may be paid only to an employee who substantiates to the payor for a calendar year at least 5,000 miles driven in connection with the performance of services as an employee of the employer or, if greater, 80 percent of the annual business mileage of that FAVR allowance. If the employee is covered by the FAVR allowance for less than the entire calendar year, these limits may be prorated on a monthly basis.

(2) A FAVR allowance may not be paid to a control employee (as defined in section 1.61-21(f)(5) and (6) of the regulations, excluding the $100,000 limitation in paragraph (f)(5)(iii)).

(3) At no time during a calendar year may a majority of the employees covered by a FAVR allowance be management employees.

(4) At all times during a calendar year at least 10 employees of an employer must be covered by one or more FAVR allowances.

(5) A FAVR allowance may be paid only with respect to an automobile (a) that is owned by the employee receiving the payment, (b) that costs, when new, at least 90 percent of the standard automobile cost taken into account for purposes of determining the FAVR allowance for the first calendar year the employee receives the allowance with respect to that automobile, and (c) the model year of which does not differ from the current calendar year by more than the number of years in the retention period.

(6) The insurance cost component of a FAVR allowance must be based on the rates charged in the base locality for insurance coverage on the standard automobile during the current calendar year without taking into account such rate-increasing factors as poor driving records or young drivers.

(7) A FAVR allowance may be paid only to an employee whose insurance coverage limits on the automobile with respect to which the FAVR allowance is paid are at least equal to the insurance coverage limits used to compute the periodic fixed payment under that FAVR allowance.

.06 *Employee reporting.*

Within 30 days after an employee's automobile is initially covered by a FAVR allowance, or is again covered by a FAVR allowance if such coverage has lapsed, the employee by written declaration must provide the payor with the following information: (a) the make, model, and year of the automobile owned by the employee, (b) written proof of the insurance coverage limits on the automobile, (c) the odometer reading of the automobile, (d) the purchase price of the automobile, and (e) whether the employee has claimed depreciation with respect to the automobile using any of the depreciation methods prohibited by section 7.04(1) above. The information described in (a), (b), and (c) of the preceding sentence also must be supplied by the employee to the payor within 30 days after the beginning of each calendar year that the employee's automobile is covered by a FAVR allowance.

.07 *Payor recordkeeping and reporting.*

(1) The payor or its agent must maintain written records setting forth (a) the statistical data and projections on which the FAVR allowance payments are based, and (b) the information provided by the employees pursuant to section 7.06 above.

(2) Within 30 days of the end of each calendar year, the employer must provide each employee covered by a FAVR allowance during that year with a statement listing the amount of depreciation included in each periodic fixed payment portion of the FAVR allowance paid during that calendar year and explaining that by receiving a FAVR allowance the employee has elected to exclude the automobile from ACRS pursuant to section 168(f)(1) of the Code.

.08 *Failure to meet section 7 requirements.*

If an employee receives a mileage allowance that fails to meet one or more of the requirements of this section 7, the employee may not be treated as covered by any FAVR allowance of the payor during the period of such failure. Nevertheless, the expenses to which that mileage allowance relates may be deemed substantiated using the method described in section 4 above and section 8.01(1) and 8.02 below to the extent the requirements of those sections are met.

SEC. 8. ACCOUNTING TO PAYOR

.01 If a payor pays a mileage allowance in lieu of reimbursing actual transportation expenses incurred or to be incurred by an employee, the amount of the expenses that is deemed substantiated to the payor is either

(1) for any mileage allowance other than a FAVR allowance (as described in section 7 above), the lesser of the amount paid under the mileage allowance or the applicable standard mileage rate in section 4.01 or 5.01 above multiplied by the number of business miles substantiated by the employee; or

(2) for a FAVR allowance (as described in section 7 above), the amount paid under the FAVR allowance less the sum of (a) any portion of a periodic variable payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return to the payor although required to do so, (b) any portion of a periodic fixed payment that relates to a period during which the employee was not covered by the FAVR allowance and that the employee fails to return to the payor although required to do so, and (c) any optional high mileage payments.

.02 If the amount of a transportation expense is deemed substantiated under the rule provided in section 8.01 above, and the employee actually substantiates to the payor the elements of time, place (or use), and business purpose of the transportation expense in accordance with paragraphs (b)(2) (travel away from

home), (b)(6) (listed property, which includes passenger automobiles and any other property used as a means of transportation), and (c) of section 1.274-5T of the temporary regulations, the employee is deemed to satisfy the adequate accounting requirements of section 1.274-5T(f) as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of section 1.274-5T(c).

.03 An arrangement providing mileage allowances will be treated as satisfying the requirement of section 1.62-2T(f)(2) of the temporary regulations with respect to returning amounts in excess of expenses as follows:

(1) For a mileage allowance other than a FAVR allowance (as described in section 7 above), the requirement to return excess amounts will be treated as satisfied if the employee is required to return any portion of such an allowance that relates to miles of travel not substantiated by the employee, even though the arrangement does not require the employee to return the portion of such an allowance that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an advance mileage allowance of $60 based on an anticipated 200 business miles at 30 cents per mile (at a time when the applicable business standard mileage rate is 26 cents per mile), and the employee substantiates 120 business miles. The requirement to return excess amounts will be treated as satisfied if the employee is required to return the portion of the allowance that is attributable to the 80 unsubstantiated business miles ($24), even though the employee is not required to return the portion of the allowance ($4.80) that exceeds the amount of the employee's expenses deemed substantiated under section 8.01 above ($31.20) for the 120 substantiated business miles. However, the $4.80 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed below in section 8.05.

(2) For a FAVR allowance (as described in section 7 above), the requirement to return excess amounts will be treated as satisfied if the employee is required to return (a) any portion of a periodic variable payment received that relates to miles in excess of the business miles substantiated by the employee, and (b) any portion of a periodic fixed payment that relates to a period during which the employee was not covered by the FAVR allowance.

.04 An employee is not required to include in gross income the portion of a mileage allowance received from a payor that is less than or equal to the amount deemed substantiated under section 8.01 above, provided the employee substantiates in accordance with section 8.02 above. See section 1.274-5T(f)(2)(i) of the temporary regulations. In addition, such portion of the allowance is treated as paid under an accountable plan, is not required to be reported on the employee's Form W-2, and is exempt from the withholding and payment of employment taxes. See section 1.62-2T(c)(2) and (c)(4).

.05 An employee is required to include in gross income only the portion of a mileage allowance received from a payor that exceeds the amount deemed substantiated under section 8.01 above, provided the employee substantiates in accordance with section 8.02 above. See section 1.274-5T(f)(2)(ii) of the temporary regulations. In addition, the excess portion of the allowance is treated as paid under a nonaccountable plan, is required to be reported on the employee's Form W-2, and is subject to withholding and payment of employment taxes. See section 1.62-2T(c)(3)(ii) and (c)(5).

.06 If the amount of the expenses deemed substantiated under the rules provided in section 8.01 above is less than the amount of the employee's business transportation expenses, the employee may claim an itemized deduction for the amount by which the business transportation expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business transportation expenses, includes on Form 2106, Employee Business Expenses, the deemed substantiated portion of the mileage allowance received from the payor, and includes in gross income the portion (if any) of the mileage allowance received from the payor that exceeds the amount deemed substantiated. See section 1.274-5T(f)(2)(iii) of the temporary regulations. However, for purposes of claiming this itemized deduction, substantiation of the amount of the expenses is not required if the employee is claiming a deduction that is equal to or less than the applicable standard mileage rate multiplied by the number of business miles substantiated by the employee minus the amount deemed substantiated under section 8.01 above. The itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in section 67.

SEC. 9. EFFECT ON OTHER DOCUMENTS

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26 CFR 601.201: Rulings and determination letters.
(Also Part 1, Sections 142, 144, 150.)

Rev. Proc. 90-35

SECTION 1. PURPOSE

This revenue procedure provides that the Internal Revenue Service ordinarily will not issue rulings or determination letters regarding whether an issue of private activity bonds meets the requirements of section 142 or 144(a) of the Code if the sum of the portions of the proceeds of the issue that are used for certain purposes equals more than 5 percent of the net proceeds of the issue. This revenue procedure thus modifies section 4.01(5) of Rev. Proc. 90-3, page 402, this Bulletin, to reflect changes resulting from the enactment of the Tax Reform Act of 1986, 1986-3 (Vol. 1) C.B. 519.

SEC. 2. BACKGROUND

Section 4 of Rev. Proc. 90-3 is entitled "AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT ORDINARILY BE ISSUED."

SEC. 3. PROCEDURE

Rev. Proc. 90-3 is modified by deleting paragraph 5 of section 4.01 and substituting in its place the following new paragraph:

5. Sections 142 and 144.—Certain Exempt Facility Bonds; Qualified Small Issue Bonds.—Whether an issue of private activity bonds meets the requirements of section 142 or 144(a) of the Code, if the sum of—

(1) the portion of the proceeds

used to finance a facility in which an owner (or a related person) or a lessee (or a related person) is a user of the facility both after the bonds are issued and at any time before the bonds were issued, and

(2) the portion used to pay issuance costs and non-qualified costs, equals more than 5 percent of the net proceeds, as defined in section 150(a)(3).

SEC. 4. EFFECTIVE DATE

This revenue procedure is effective June 25, 1990, the date of its publication in the Internal Revenue Bulletin.

SEC. 5. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 90-3 is modified.

Social Security Contribution and Benefit Base

Under authority contained in the Social Security Act ("the Act"), the Secretary, Department of Health and Human Services, has determined and announced (54 F.R. 53751, dated December 29, 1989) that the contribution and benefit base for remuneration paid in 1990 and self-employment income earned in taxable years beginning in 1990 is $51,300.

"Old-Law" Contribution and Benefit Base

General

The 1990 "old-law" contribution and benefit base is $38,100. This is the base that would have been effective under the Act without the enactment of the 1977 amendments. The base is computed under section 230(b) of the Act as it read prior to the 1977 amendments, and as it has been modified by Public Law 101-239.

The "old-law" contribution and benefit base is used by:

(1) The Railroad Retirement program to determine certain tax liabilities and tier II benefits payable under that program to supplement the tier I payments which correspond to basic Social Security benefits,

(2) The Pension Benefit Guaranty Corporation to determine the maximum amount of pension guaranteed under the Employee Retirement Income Security Act (as stated in section 230(d) of the Act), and

(3) Social Security to determine a "year of coverage" in computing the "special minimum" benefit and in computing benefits for persons who are also eligible to receive pensions based on employment not covered under section 210 of the Act.

CONTENTS

CO-78-87 558
CO-10-89 559
CO-008-90 559
EE-129-86 560
EE-44-87 561
EE-61-88 573
EE-8-89 616
EE-22-90 617
FI-105-88 630
FI-64-89 631
FI-75-89 631
FI-76-89 632
GL-705-88 632
IA-237-84 633
IA-130-87 645
IA-12-89 654
IA-29-89 663
IA-012-90 678
INTL-704-87 678
INTL-40-89 679
INTL-0660-89 680
FS-53-89 681
PS-065-89 681

The "Proposed regulations" heading in the index contains a list of Code sections affected, the subject matter and the number and page.

Notice of Proposed Rulemaking

Notice of Proposed Rulemaking

Consolidated Return Regulations—Special Rules Relating to Dispositions and Deconsolidations of Subsidiary Stock

CO-78-87

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In *** [T.D. 8294, page 66, this Bulletin], the Internal Revenue Service is issuing temporary regulations that implement the repeal of the *General Utilities* doctrine and eliminate loss duplication with respect to a member of an affiliated group filing a consolidated return on a disposition or deconsolidation of stock of a subsidiary of the group. The text of the temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: The regulations in this document are proposed to be effective March 9, 1990. Section 1.337(d)-1T is proposed to apply with respect to dispositions occurring after January 6, 1987, of stock of a corporation that became a member of an affiliated group after January 6, 1987, if the disposition is not subject to §1.1502-20T. Written comments and requests for a public hearing must be delivered by September 14, 1990.

ADDRESS: Send comments and requests for a public hearing to: Internal Revenue Service, Attention: CC:CORP:T:R Room 4429, [CC:CO-78-87], P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1980 (44 U.S.C. 3504(h)). Comments on the collections of information should be sent to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP, Washington, D.C. 20224.

The collections of information in these proposed regulations are in §§1.337(d)-1T(a)(2), 1.1502-20T(b)(4), and 1.1502-20T(f)(5). This information is required by the Internal Revenue Service to comply with sections 337(d) and 1502 and the regulations thereunder. This information will be used to determine that the proper amount of tax was reported by the taxpayer and whether, and to what extent, the taxpayer's return should be audited. The likely respondents are affiliated groups of corporations filing (or required to file) consolidated returns.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents may require greater or less time, depending on their particular circumstances. Estimated total annual reporting burden: 5000 hours. The estimated burden per respondent varies from 1 hour and 30 minutes to 2 hours and 30 minutes, depending on individual circumstances, with an estimated average of 2 hours.
Estimated number of respondents: 2500.
Estimated frequency of responses: 1 time.

Background

Temporary regulations published in *** [T.D. 8294, page 66, this Bulletin] add new §§1.1502-20T, 1.1502-1T, and 1.337(d)-1T to Part 1 of Title 26 of the Code of Federal Regulations ("CFR") and add cross-references in §§1.1502-12, 1.1502-32, 1.1502-33, and 1.1502-79. The final regulations that are proposed to be based on the temporary regulations would be added to Part 1 of Title 26 of the CFR. Those final regulations generally will provide that any loss recognized by a member on the disposition of the stock of a subsidiary is disallowed, and the basis of any share of stock of a subsidiary that exceeds its fair market value (other than a share for which a loss is disallowed) is reduced to an amount equal to its fair market value immediately before the stock of the subsidiary is no longer owned by a member of any consolidated group of which the subsidiary is also a member. For the text of the new temporary regulations, see T.D. 8294, *** [page 66, this Bulletin]. The preamble to the temporary regulations explains the proposed regulations.

Special Analysis

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It is hereby certified that the proposed rules will not have a significant impact on a substantial number of small entities. The rule would primarily affect affiliated groups of corporations filing (or required to file) consolidated returns, which tend to be larger businesses. It would not significantly alter the reporting or recordkeeping duties of small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. Chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted, consideration will be given to any written comments that are submitted (preferably nine copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing is scheduled for Tuesday, October 16, 1990, and will continue, if necessary, on Wednesday, October 17, 1990. Notice of the public hearing is published in *** Announcement 90-49, 1990-15 I.R.B. 37.

Proposal of Regulations

The temporary regulations, T.D. 8294 *** [page 66, this Bulletin], are hereby also proposed as final regulations under sections 337(d) and 1502

of the Internal Revenue Code of 1986.

Fred T. Goldberg, Jr.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on March 9, 1990, 2:19 p.m., and published in the issue of the Federal Register for March 14, 1990, 55 F.R. 9463 and corrected by 55 FR 9920)

Notice of Proposed Rulemaking

Limitations on Corporate Net Operating Loss Carryforwards

CO-10-89

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: Temporary regulations at §§1.382-1T and -2T were published in the Federal Register on August 11, 1987, 52 FR 29663, [T.D. 8149, 1987-2, C.B. 85] to provide guidance regarding what constitutes an "ownership change" under section 382, after which certain corporate attributes, such as net operating loss carryforwards, are limited. In *** [T.D. 8277, page 96, this Bulletin], the Internal Revenue Service is amending the temporary regulations under section 382 of the Internal Revenue Code (Code) to grant the Service Authority to issue revenue rulings (or other guidance in the Internal Revenue Bulletin) to provide additional exceptions under §1.382-2T(h)(4)(x) to the operation of the option attribution rules at §1.382-2T(h)(4)(i) to loss corporations. This amendment of the regulations will give the Treasury Department greater flexibility in providing additional exceptions to the attribution rules of §1.382-2T(h)(4)(i), as circumstances justifying those exceptions are identified. The text of the temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: Written comments and requests for a public hearing must be mailed by February 26, 1990. The regulations are proposed to be effective on the date the final regulations are published in the Federal Register.

ADDRESS: Send comments or requests for a public hearing to: Internal Revenue Service, Attention: CC:CORP:T:R [CO-10-89], Room 4429, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SUPPLEMENTARY INFORMATION:

Background

The *** [T.D. 8277, page 96, this Bulletin] contains temporary regulations that amend the temporary regulations at §1.382-2T by adding a new paragraph (h)(4)(x)(Z). The final regulations which are proposed to be based on the temporary regulations would be added to Part 1 of Title 26 of the Code of Federal Regulations. As proposed, the final regulations would grant the Service the authority to designate in the Internal Revenue Bulletin additional options that would be excepted from the option attribution rules of §1.382-2T(h)(4)(i).

For the text of the temporary regulations, see T.D. 8277 published in *** [page 96, this Bulletin]. The preamble to the temporary regulations explains the amended regulations.

Special Analyses

It has been determined that these proposed regulations are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing will be held upon written request by any person who has submitted written comments. If a public hearing is held, notice of time and place will be published in the Federal Register.

Fred T. Goldberg, Jr.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on December 22, 1989, 8:45 a.m., and published in the issue of the Federal Register for December 26, 1989, 54 F.R. 52955)

Notice of Proposed Rulemaking

Consolidated Return Regulations—Modification of Rules Relating to Intercompany Transactions and Distributions of Property

CO-008-90

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary and final regulations.

SUMMARY: In *** [T.D. 8295, page 165, this Bulletin], the Internal Revenue Service is issuing temporary and final regulations relating to deferred intercompany transfers and distributions of property among members of an affiliated group filing consolidated returns. As a result of changes to the Internal Revenue Code, literal application of the deferral rules may produce tax consequences to the group that are inconsistent with the tax consequences that would have resulted if an intercompany transfer had not occurred.

The temporary regulations provide rules concerning the creation and restoration of deferred gain or loss in these transfers. The purpose of the temporary regulations is to confirm the original intent of the deferral mechanism by assuring that intercompany transfers generally do not affect the overall federal income tax consequences to the group.

The text of the temporary and final regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: The regulations are proposed to be effective for taxable years for which the due date (without extensions) of the Federal income tax return is after March 14, 1990. However, transition rules §§1.1502-13T(m)(4)(ii) and 1.1502-14T(c)(3)(ii) apply to certain dispositions outside the group occurring before March 9, 1990. In addition, §1.1502-13T(n) applies only to deferred intercompany transactions attributable to long term contracts entered into after June 20, 1988. Written comments must be delivered by May 14, 1990. Outlines for persons wishing to speak at the public hearing scheduled for Monday, July 9, 1990, must be delivered by June 25, 1990. *See* the Notice of Hearing published in *** [Announcement 90-52, 1990-16 I.R.B. 20].

ADDRESS: Send comments and outlines to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Attn: CC:CORP:T:R (CC:CO-008-90), Room 4429, Washington, D.C. 20044.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1980 (44 U.S.C. 3504(h)). Comments on the collections of information should be sent to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503, with copies to the Internal Revenue Service, Attention: IRS Reports Clearance Officer, T:FP, Washington, D.C. 20224.

The collections of information requirements in these regulations are in §1.1502-13T and §1.1502-14T. This information is required by the Internal Revenue Service to comply with section 1502 and the regulations thereunder. This information will be used to determine whether a taxpayer entered into certain transactions prior to the effective date of the regulations. The likely respondents are common parents of affiliated groups of corporations filing consolidated returns.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents may require greater or less time, depending on their particular circumstances.

Estimated total annual reporting burden: 5000 hours.

The estimated burden per respondent varies from 1 hour 30 minutes to 2 hours 30 minutes, depending on individual circumstances, with an estimated average of 2 hours.

Estimated number of respondents: 2500.

Estimated frequency of responses: 1 time.

Background

The temporary and final regulations published in *** [T.D. 8295, page 165, this Bulletin] amend the Income Tax Regulations (26 CFR Part 1) under section 1502 of the Internal Revenue Code of 1986. These regulations amend temporary regulations §§1.1502-13T and 1.1502-14T and amend and add cross-references to §§1.1502-13 and 1.1502-14. The final regulations that are proposed to be based on those temporary regulations would be added to Part 1 of Title 26 of the Code of Federal Regulations. Those final regulations would provide rules relating to the creation of deferred gain and its restoration when, for example, property on which gain was previously deferred is depreciated by or is disposed of outside an affiliated group filing consolidated federal income tax returns.

For the text of the new temporary regulations, see T.D. 8295, *** [page 165, this Bulletin]. The preamble to the temporary regulations explains the regulations.

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted, consideration will be given to any written comments that are submitted (preferably nine copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing is scheduled for Monday, July 9, 1990. Notice of the public hearing is published in *** Announcement 90-52, 1990-16 I.R.B. 20.

Charles H. Brennan,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on March 9, 1990, 2:14 p.m., and published in the issue of the Federal Register for March 14, 1990, 55 F.R. 9462)

Notice of Proposed Rulemaking

Definition of Compensation

EE-129-86

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In *** [T.D. 8301, page 99, this Bulletin], the Internal Revenue Service is issuing temporary regulations relating to the scope and meaning of the term "compensation" in section 414(s) of the Internal Revenue Code of 1986. They reflect changes made by the Tax Reform Act of 1986 (TRA '86) [Pub. L. 99-514, 1986-3 C.B. (Vol. 1) 1] and by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) [Pub. L. 100-647, 1988-3 C.B. 1]. The text of those temporary regulations also serves as the text for this Notice of Proposed Rulemaking. These regulations will provide the public with guidance necessary to comply with the law and will affect sponsors of, and participants in, pension, profit-sharing and stock bonus plans, and certain other employee benefit plans.

DATES: Written comments must be received by July 13, 1990. Requests to speak (with outlines of oral comments) at a public hearing scheduled for Wednesday, September 26, 1990, at 10:00 a.m., and continuing at 10:00 a.m. each day, if necessary, on Thursday, September 27, 1990, and Friday, September 28, 1990, must be received by Wednesday, September 12, 1990. See the notice of hearing published elsewhere in *** [Announcement 90-78, 1990-23 I.R.B. 50].

ADDRESSES: Send comments and requests to speak (with outlines of oral comments) at the public hearing to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Attn: CC:CORP:T:R (EE-129-86), Room 4429, Washington, D.C. 20044.

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations in *** [T.D. 8301, page 99, this Bulletin] amend 26 CFR by amending §1.414(s)-1T and §1.415-2(d) to provide guidance with respect to definitions of compensation within the meaning of section 414(s) and section 415(c)(3) of the Internal Revenue Code (Code). The regulations are proposed to be issued under the authority contained in sections 414(s) and 7805 of the Code (100 Stat. 2453, 68A Stat. 917; 26 U.S.C. 414(s), 7805). For the text of the temporary regulations, see T.D. 8301 published in *** [page 99, this Bulletin].

Special analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the proposed regulations are being sent to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and requests for public hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably a signed original and eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying in their entirety. Because the Treasury Department expects to issue final regulations on this matter as soon as possible, a public hearing will be held at 10:00 a.m. on September 26, 1990, and continued, if necessary, on September 27 and 28, 1990, in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Ave., N.W., Washington, D.C. Comments must be received by July 13, 1990. Requests to speak (with outlines of oral comments) must be received by Wednesday, September 12, 1990. See the notice of hearing published elsewhere in *** [Announcement 90-78, 1990-23 I.R.B. 50].

List of Subjects

26 CFR 1.401-0—1.425-1

Employee benefit plans, Employee stock ownership plans, Income taxes, Individual retirement accounts, Pensions, Stock options.

Fred T. Goldberg, Jr.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on May 10, 1990, 8:45 a.m., and published in the issue of the Federal Register for May 14, 1990, 55 F.R. 19945)

Notice of Proposed Rulemaking

Minimum Participation

EE-44-87

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains a proposed regulation relating to minimum participation requirements under section 401(a)(26) of the Internal Revenue Code of 1986. The proposed regulation reflects changes made by section 1112(b) and (e) of the Tax Reform Act of 1986 (TRA '86) [Pub. L. 99-514, 1986-3 C.B. (Vol. 1) 1, 357], and sections 1011(h), 6055 and 6065 of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) [Pub. L. 100-647, 1988-3 C.B. 1, 124, 357, 362]. The regulation will provide the public with guidance on the minimum participation requirements and will affect sponsors of, and participants in, qualified pension, profit-sharing and stock bonus plans.

This regulation is being issued in conjunction with regulations under section 401(a)(4). The section 401(a)(4) regulations, in combination with the minimum coverage requirements of section 410(b), result in a coordinated nondiscrimination rule that prohibits a qualified retirement plan from being designed or operated to favor highly compensated employees. Because the proposed regulations being issued under section 401(a)(4) set out clear and comprehensive nondiscrimination tests for the first time, it has been possible to substantially simplify the legal and administrative requirements contained in the proposed regulation under section 401(a)(26).

DATES: Written comments must be received by July 13, 1990. Requests to speak (with outlines of oral comments) at a public hearing scheduled for Wednesday, September 26, 1990, at 10:00 a.m., and continuing at 10:00 a.m. each day, if necessary, on Thursday, September 27, 1990, and Friday, September 28, 1990, must be received by Wednesday, September 12, 1990. See notice of hearing published elsewhere in * * * [Announcement 90-78, 1990-23 I.R.B. 50].

ADDRESSES: Send comments, requests to appear at the public hearing, and outlines of comments to be presented to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Attention: CC:CORP:T:R (EE-44-87), Room 4429, Washington, DC 20044.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On February 14, 1989, the Federal Register (FR 6710) published pro-

posed amendments to the Income Tax Regulations (26 CFR Part 1) under section 401(a)(26) of the Internal Revenue Code of 1986 (Code) [EE-44-87, 1989-1 C.B. 988]. The proposed amendments conformed the regulations to section 1112(b) and (e) of TRA '86 (100 Stat 2444), and sections 1011(h), 6055 and 6065 of TAMRA (102 Stat 3464). A public hearing on the proposed regulation was announced in 54 FR 32453 [Announcement 89-108, 1989-36 I.R.B. 26] and held on October 30, 1989. After consideration of all comments regarding the proposed regulation, the proposed regulation is withdrawn, and a new proposed regulation is added in its place.

SPECIAL ANALYSES

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to this regulation, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this proposed regulation will be submitted to the Administrator of the Small Business Administration for comment on its impact on small business.

COMMENTS AND REQUESTS TO APPEAR AT THE PUBLIC HEARING

Before adopting this proposed regulation, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying in their entirety. Because the Treasury Department expects to issue a final regulation on this matter as soon as possible, a public hearing will be held at 10:00 a.m. on Wednesday, September 26, 1990, and continued, if necessary, on September 27 and 28, 1990, in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Ave., N.W., Washington, D.C. Written comments must be received by July 13, 1990. Requests to speak (with outlines of oral comments) at the public hearing must be received by Wednesday, September 12, 1990. See notice of hearing published elsewhere in * * * [Announcement 90-78, 1990-23 I.R.B. 50].

APPROACH TAKEN IN DRAFTING

The proposed regulation has been drafted with the objective of providing guidance that is simple, clear, and administrable. Design-based safe harbors are provided, where appropriate, in order to simplify the testing process while providing certainty in plan design. Flexible testing approaches based on facts and circumstances are provided in situations where the slight increase in certainty provided by objective numerical testing standards would be significantly outweighed by the administrative problems of data collection and numerical calculations.

AMENDMENTS TO QUALIFIED PLANS

Generally, section 401(a)(26) imposes new minimum participation requirements that plans must meet in order to be qualified under section 401(a). These rules are, in general, operational. To the extent that a plan does not meet the requirements of section 401(a)(26), the plan must be amended as of the date provided herein in order to retain qualification, such amendment to be effective as of the first day of the first plan year to which section 401(a)(26) applies.

STATUTORY ANALYSIS

Section 401(a)(26) requires that each qualified plan benefit at least the lesser of 50 employees or 40 percent of all employees of the employer (the minimum participation rule). The minimum participation rule applies separately to each qualified plan of an employer. Section 401(a)(26) generally is effective with respect to plan years beginning after December 31, 1988.

INTRODUCTION

The section 401(a)(26) minimum participation rules were added by TRA '86 in conjunction with amendments to the minimum coverage requirements of section 410(b). The primary purpose of section 401(a)(26), like section 410(b) and section 401(a)(4), is to ensure that tax favored pension, stock bonus or profit sharing plans do not discriminate in favor of the highly compensated employees of the employer maintaining the plan. Together the three provisions require that the coverage of rank and file employees bear a reasonable relationship to the coverage of highly compensated employees and that the benefits provided to rank and file employees be substantially equivalent to the benefits provided to highly compensated employees.

Specifically, Congress enacted section 401(a)(26) to address two fundamental concerns. First, the rules are intended to promote the nondiscriminatory provision of benefits by limiting the extent to which an employer is able to design different benefit formulas for different employees in order to maximize benefit disparities in favor of highly compensated employees. Second, the rules are intended to limit the extent to which a defined benefit plan operates as an individual account for one employee, or a small group of the employer's employees, by currently benefiting only one or a few of the employer's highly compensated employees or by maintaining accrued benefits for only one or a few such employees.

WITHDRAWAL AND REPROPOSAL OF THE SECTION 401(a)(26) REGULATION

The proposed regulation under section 401(a)(26) was published on February 14, 1989 (54 FR 6710). Comments were requested and a hearing was held on October 30, 1989.

As a result of these comments, and similar comments received on related provisions, the Internal Revenue Service undertook a comprehensive reexamination of existing guidance on participation, coverage, and nondiscrimination. The goal of this reexamination was to develop a coordinated set of greatly simplified rules that would implement the nondiscrimination policies of the Tax Reform Act of 1986 (TRA '86).

The cornerstone of this review has been the development of new proposed regulations under section 401(a)(4) relating to nondiscrimination in contributions or benefits. These regulations are being issued

simultaneously with the reproposed section 401(a)(26) proposed regulation and address such areas as comparability and the average benefits test under section 410(b). Also, additional regulatory guidance is being issued on permitted disparity under section 401(l), the definition of compensation under section 414(s), the compensation limitation of section 401(a)(17), and other related provisions.

As a result of the guidance provided in the proposed regulations under section 401(a)(4), it has been possible to significantly simplify many aspects of the proposed regulation under section 401(a)(26) that was published in the Federal Register on February 14, 1989 (prior regulation). These changes necessitate the withdrawal of the prior regulation and the insertion of these proposed amendments (proposed regulation).

SIGNIFICANT CHANGES

Current benefit structure testing.

Section 401(a)(26)(I) states that the Secretary may provide that any separate benefit structure, trust, or other arrangement is to be treated as a separate plan for purposes of section 401(a)(26). The statutory provision for separate testing of current benefit structures is to be exercised, where necessary, to limit the extent to which an employer is able to design different benefit formulas for different employees to maximize benefit disparities in favor of highly compensated employees while treating the formulas as comparable for purposes of sections 410 and 401(a)(4).

The prior regulation exercised this grant of authority by providing that any differences in benefits, rights, and features in a plan create separate current benefit structures that each must satisfy section 401(a)(26) separately. In this proposed regulation, the Secretary has greatly simplified the prior regulation by eliminating all current benefit structure testing. The decision not to exercise the statutory grant of discretion to test separate current benefit structures under section 401(a)(26) at this time was made because we believe that the relevant underlying statutory purpose of section 401(a)(26) is adequately addressed by the simultaneous publication of comprehensive guidelines on the nondiscrimination requirements under section 401(a)(4). These proposed section 401(a)(4) regulations address many of the potential sources of significant benefit disparity addressed in the legislative history to section 401(a)(26).

The inherent interrelationship between the nondiscrimination rules of section 401(a)(4) and the requirements of section 401(a)(26) is evidenced by the legislative history to section 401(a)(26) and has been an important factor in the reexamination of the regulation under section 401(a)(26). This direct interrelationship is most apparent in the context of exercising the statutory grant of regulatory authority to define and test separate benefit structures, thereby limiting the extent to which plan benefits differ in ways that maximize benefits for highly compensated employees without providing comparable benefits for rank and file employees.

Specifically, in enacting section 401(a)(26), Congress reviewed and criticized the positions taken by the Service in Revenue Ruling 81-202, 1981-2 C.B. 93, in interpreting the nondiscrimination requirements of section 401(a)(4). That ruling sets forth rules for comparing differences in benefit formulas, distribution forms, and other benefits, rights, and features under plans that are tested as a single plan to satisfy the requirements of section 401(a)(4) and 410(b).

The legislative history elaborating on the provisions of and need for section 401(a)(26) focuses on the nondiscrimination testing methodology of Rev. Rul. 81-202 and enumerates a number of areas in which the comparability analysis of Rev. Rul. 81-202 fails to adjust for differences in benefits, rights, and features that are of significant value to employees. The legislative history further recognizes the difficulty of developing rules that adequately adjust for some of these differences.

The proposed regulations being issued simultaneously under section 401(a)(4) directly address the testing methodology of Rev. Rul. 81-202 in addition to developing guidance on related aspects of nondiscrimination testing under section 401(a)(4). The comprehensive guidance on section 401(a)(4) nondiscrimination testing provided under these regulations specifically addresses the congressional criticism of nondiscrimination testing reflected in the legislative history to section 401(a)(26).

Prior benefit structure testing.

The proposed regulation substantially reduces the complexity of the section 401(a)(26) testing requirements for prior benefit structures. The proposed regulation, like the prior regulation, requires testing of prior benefit structures only in the case of defined benefit plans and treats all prior benefit accruals as a single benefit structure. The prior regulation provided six alternative tests that an employer could apply in satisfying section 401(a)(26) for a prior benefit structure. In contrast, the proposed regulation provides a single flexible prior benefit structure test.

Testing methodology.

Section 401(a)(26) requires that a plan satisfy the stated requirements on each day of a plan year. The prior regulation also provided for testing on this basis. In response to comments, and in order to reduce the testing burden on employers and better integrate testing requirements under sections 401(a)(26), 410(b), and 401(a)(4), the proposed regulation provides a simplified method for testing under section 401(a)(26). Under this simplified method, a plan may satisfy section 401(a)(26) on a single day in a plan year, as long as the day selected is reasonably representative of the employer's workforce and the plan's coverage.

ANALYSIS

Applicable to plans separately.

Section 401(a)(26) applies separately to each plan of the employer. Thus, plans may not be aggregated to satisfy the requirements of section 401(a)(26) even where the plans are identical in all respects or where the plans are treated as a single plan for purposes of section 401(a)(4) and section 410(b).

The proposed regulation provides generally that each single plan within the meaning of section 414(l) is a separate plan for purposes of section 401(a)(26). A plan that is treated as a single plan under section 414(l) is,

however, treated as comprising separate plans if disaggregated pursuant to the proposed regulation. Examples of situations in which the proposed regulation provides for disaggregation are as follows: 1) the plan benefits both collectively bargained and non-collectively bargained employees; 2) the plan contains an employee stock ownership (ESOP) component and a non-ESOP component; or 3) the plan is maintained by more than one employer (multiple employer plan). In general, these disaggregation provisions parallel similar provisions in section 410(b) and section 401(a)(4).

Plans that are excepted from section 401(a)(26).

The proposed regulation provides four exceptions to section 401(a)(26). Plans meeting the requirements of these exceptions are treated as satisfying section 401(a)(26) without further testing of participation under the plan.

1. *Plans not benefiting highly compensated employees.*

A plan, other than a top-heavy plan under section 416, satisfies section 401(a)(26) if the plan does not currently benefit any employee or former employee who is a highly compensated employee of the employer. The proposed regulation eliminates a five-year lookback requirement imposed on this exception in the prior regulation.

2. *Multiemployer plans.*

A multiemployer plan, or portion thereof, that benefits only employees included in a unit of employees covered by a collective bargaining agreement is not required to meet the minimum participation requirements of section 401(a)(26). A multiemployer plan that also covers employees not included in a unit of employees covered by a collective bargaining agreement is required to satisfy section 401(a)(26). A special testing rule added to the proposed regulation, however, permits such multiemployer plans to satisfy section 401(a)(26) if the plan as a whole benefits at least 50 employees.

3. *Underfunded defined benefit plans.*

Certain underfunded defined benefit plans are treated as satisfying the requirements of section 401(a)(26). The proposed regulation expands the availability of this exception by removing three and five year limitations imposed in the prior regulation.

4. *Acquisitions and dispositions.*

The proposed regulation provides that rules similar to the rules in section 410(b)(6)(C) apply in the event of an acquisition or disposition.

Minimum participation requirements.

If a plan does not satisfy one of the exceptions mentioned above, the plan must satisfy section 401(a)(26) for the plan year. A plan generally satisfies section 401(a)(26) for a plan year if the plan benefits the lesser of 50 employees of the employer or 40 percent of the employees of the employer.

A defined contribution plan satisfies this requirement if it provides current benefits to the requisite number of employees of the employer and satisfies the requirement automatically if it does not currently benefit any employees or former employees. A defined benefit plan satisfies this requirement with respect to current accruals by providing a current benefit to the requisite number of employees of the employer and satisfies the requirement with respect to its prior benefit structure if the requisite number of employees either have a meaningful accrued benefit or are currently receiving a meaningful benefit accrual. Former employees may be aggregated with employees in establishing that the requisite number of employees have a meaningful accrued benefit under the plan.

A defined benefit plan that is a multiemployer plan satisfies the prior benefit structure rule for a plan year if the multiemployer plan either provides meaningful benefits to at least 50 employees for a plan year, or 50 employees have meaningful accrued benefits under the plan. For purposes of this rule, all employees benefiting under the multiemployer plan may be considered.

The determination of whether the employer is providing (or has provided) meaningful benefits is based on all of the facts and circumstances in a manner consistent with the section 401(a)(26) policy objective of limiting the extent to which a defined benefit plan operates as an individual account for one employee or a small group of employees. Accordingly, an ongoing defined benefit plan will typically satisfy the prior benefit structure requirements concurrently with satisfaction of the general plan requirements. A plan that satisfies one of the six prior benefit structure tests in §1.401(a)(26)-6 of the prior proposed regulation is deemed to satisfy this requirement.

Testing former employees.

The proposed regulation provides that if a defined benefit plan provides additional benefits to former employees during a plan year, the plan must satisfy section 401(a)(26) with respect to former employees. A plan satisfies section 401(a)(26) with respect to former employees if the plan either satisfies the minimum participation rule (i.e., benefits at least the lesser of 50 former employees or 40 percent of the former employees of the employer) or satisfies a special rule provided in the proposed regulation. This special rule is satisfied if a plan benefits at least 5 former employees and either benefits more than 95 percent of all former employees with accrued benefits under the plan or at least 60 percent of the former employees receiving an additional benefit are non-highly compensated employees.

Testing methods.

Section 401(a)(26) requires that a plan satisfy section 401(a)(26) on each day of the plan year. The proposed regulation, however, provides a simplified testing method. Under the simplified testing method, a plan is treated as satisfying section 401(a)(26) if the plan satisfies section 401(a)(26) on a single day during the plan year as long as the day selected is reasonably representative of the employer's employees and the plan's coverage.

Transition rules.

The proposed regulation provides a special transition rule for governmental plans and certain section 403(b) annuities. Also, the proposed regulation provides special transition rules for early retirement "window period" benefits and plans that have a minimum-period-of-service require-

ment or a last-day-of-the-year requirement.

Effective date.

Section 401(a)(26) generally is effective with respect to plan years beginning after December 31, 1988. A deferred effective date applies with respect to certain collectively bargained plans.

Delegation to the Commissioner.

The proposed regulation contains a delegation of authority to the Commissioner to provide additional guidance by revenue rulings, notices or other documents of general applicability, as may be necessary or appropriate for the application of the proposed regulation. No inferences should be drawn with respect to the manner in which the Commissioner may exercise other delegations of authority provided for in this or other regulations.

Reliance on This Proposed Regulation

Taxpayers may rely on this regulation for guidance pending issuance of a final regulation. If a future regulation is more restrictive, such guidance will be applied without retroactive effect.

List of subjects in 26 CFR 1.401-0—1.425-1

Income taxes, Employee benefit plans, Pensions.

Proposed amendments to the regulation

The proposed amendments to 26 CFR Part 1 are as follows:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. The authority citation for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805 * * * §§1.401(a)(26)-1 through (a)(26)-8 also issued under 26 U.S.C. 401(a)(26).* * *

Par. 2. New §§1.401(a)(26)-0 through 1.401(a)(26)-9 are added to read as follows:

§1.401(a)(26)-0 Table of contents.

This section lists the paragraphs contained in §§1.401(a)(26)-1 through 1.401(a)(26)-9.

§1.401(a)(26)-1. Minimum participation requirements.

(a) General rule.
(b) Exceptions to section 401(a)(26).
(1) Plans that do not benefit any highly compensated employees.
(2) Multiemployer plan exception.
(3) Certain underfunded defined benefit plans.
(4) Qualified cash or deferred arrangements maintained by employers that include certain governmental or tax-exempt entities.
(5) Certain acquisitions or dispositions.
(c) Additional rules.

§1.401(a)(26)-2. Minimum participation rule.

(a) General rule.
(b) Frozen plans.
(1) Defined contribution plans.
(2) Defined benefit plans.
(c) Plan.
(1) In general.
(2) Separate asset pools are separate plans.
(d) Disaggregation of certain plans.
(1) Plans benefiting collectively bargained employees.
(2) ESOPs.
(3) Plans benefiting otherwise excludable employees.
(4) Plans maintained by more than one employer.
(5) Defined benefit plans with other arrangements.

§1.401(a)(26)-3. Rules applicable to a defined benefit plan's prior benefit structure.

(a) General rule.
(b) Prior benefit structure.
(c) Testing a prior benefit structure.
(1) General rule.
(2) Meaningful benefits.
(d) Multiemployer plan rule.

§1.401(a)(26)-4. Testing former employees.

(a) Scope.
(b) Minimum participation rule for former employees.
(c) Special rule.
(d) Excludable former employees.
(1) General rule.
(2) Exception.

§1.401(a)(26)-5. Employees who benefit under a plan.

(a) Benefiting under a plan.
(b) Section 401(k) and section 401(m).
(c) Certain plan limits.
(d) Sequential or concurrent benefit offset arrangements.
(1) In general.
(2) Offset by sequential or grandfathered benefits.
(3) Concurrent benefit offset arrangements.

§1.401(a)(26)-6. Excludable employees.

(a) In general.
(b) Excludable employees.
(1) Minimum age and service exclusions.
(2) Certain air pilots.
(3) Certain nonresident aliens.
(4) Employees covered pursuant to a collective bargaining agreement.
(5) Employees not covered pursuant to a collective bargaining agreement.
(6) Examples.
(7) Certain terminating employees.
(c) Excludable former employees.
(1) Rules analogous to excludable employee rules.
(2) Pre-1984 former employees.
(3) Pre-retirement former employees.
(4) Vested accrued benefits eligible for mandatory distribution.
(d) Certain police or firefighters.

§1.401(a)(26)-7. Testing methods.

(a) Testing on each day of the plan year.
(b) Simplified testing method.
(c) Retroactive correction.

§1.401(a)(26)-8. Definitions.

(a) Collective bargaining agreement.
(b) Defined benefit plan.
(c) Defined contribution plan.
(d) Employee.
(e) Employer.
(f) Former employee.
(g) Highly compensated employee.
(h) Highly compensated former employee.
(i) Multiemployer plan.
(j) Nonhighly compensated employee.
(k) Professional.

§1.401(a)(26)-9. Effective dates and transition rules.

(a) In general.
(b) Transition rules.

(1) Governmental plans and certain section 403(b) annuities.

(2) Early retirement "window-period" benefits.

(3) Employees who do not benefit because of a minimum-period-of-service requirement or a last-day requirement.

(4) Certain plan terminations.

(c) Waiver of excise tax on reversions.

(1) In general.

(2) Termination date.

(3) Failure to satisfy section 401(a)(26).

(d) Special rule for collective bargaining agreements.

§1.401(a)(26)-1. Minimum participation requirements.

(a) *General rule.* A plan is a qualified plan for a plan year only if the plan satisfies section 401(a)(26) for the plan year. A plan that satisfies any of the exceptions described in paragraph (b) of this section passes section 401(a)(26) automatically for the plan year. A plan that does not satisfy one of the exceptions in paragraph (b) of this section must satisfy §1.401(a)(26)-2(a). In addition, a defined benefit plan must satisfy §1.401(a)(26)-3 with respect to its prior benefit structure. Finally, a defined benefit plan that benefits former employees (for example, a defined benefit plan that is amended to provide an ad hoc cost of living adjustment to former employees) must separately satisfy §1.401(a)-(26)-4 with respect to its former employees.

(b) *Exceptions to section 401(a)-(26)*—(1) *Plans that do not benefit any highly compensated employees.* A plan, other than a frozen defined benefit plan as defined in §1.401(a)-(26)-2(b)(2)(ii), satisfies section 401(a)(26) for a plan year if the plan is not a top-heavy plan under section 416 and the plan meets the following requirements:

(i) No employee or former employee who is a highly compensated employee of the employer (either as an employee, former employee, or both) accrues a benefit for the plan year; and

(ii) The plan is not aggregated with any other plan of the employer to enable the other plan to satisfy section 401(a)(4) or 410(b). The plan may, however, be aggregated with the employer's other plans for purposes of the average benefit percentage test in section 410(b)(2)(A)(ii).

(2) *Multiemployer plan exception*—(i) *In general.* The portion of a multiemployer plan that benefits only employees included in a unit of employees covered by a collective bargaining agreement may be treated as a separate plan that satisfies section 401(a)(26) for a plan year. If this exception is used, and the multiemployer plan also benefits employees who are not included in any collective bargaining unit covered by a collective bargaining agreement, the portion of the plan benefiting such employees must separately satisfy section 401(a)(26).

(ii) *Special testing rule for multiemployer plans covering non-collectively bargained employees.* A multiemployer plan that benefits employees who are not included in any collective bargaining unit covered by a collective bargaining agreement satisfies section 401(a)(26) if the plan benefits 50 employees. For purposes of this special testing rule employees who are included in a unit of employees covered by a collective bargaining agreement may be included in determining whether the plan benefits 50 employees.

(iii) *Covered by a collective bargaining agreement.* An employee is covered by a collective bargaining agreement only if the employee is represented by a bona fide employee representative that is a party to a collective bargaining agreement under which the multiemployer plan is maintained.

(iv) *Multiemployer plans covering professional employees.* A collective bargaining agreement is not a collective bargaining agreement for purposes of this paragraph (b)(2) if, for the plan year, more than 2 percent of the employees who are covered pursuant to the agreement are professionals as defined in §1.401(a)(26)-8(k). In addition, the special testing rule in paragraph (b)(2)(ii) of this section is not available if, for the plan year, more than 2 percent of the benefiting employees of any employer who are not included in any collective bargaining unit covered by a collective bargaining agreement are professional employees as defined in §1.401(a)(26)-8(k).

(3) *Certain underfunded defined benefit plans*—(i) *In general.* A defined benefit plan is deemed to satisfy section 401(a)(26) for a plan year if all of the conditions of paragraphs (b)(3)(ii) through (b)(3)(iv) of this section are satisfied with respect to the plan for the plan year.

(ii) *Eligible plans.* This condition is satisfied for a plan year only if the plan is subject to Title IV of the Employee Retirement Income Security Act of 1974 (ERISA) for the plan year or is not a top-heavy plan within the meaning of section 416. This condition does not apply for plan years beginning before January 1, 1992.

(iii) *Actuarial certification.* This condition is satisfied for a plan year only if the employer's timely filed actuarial report, as required by section 6059, evidences that the plan does not have sufficient assets to satisfy all liabilities under the plan (determined in accordance with section 401(a)(2)).

(iv) *Cessation of all benefit accruals.* This condition is satisfied for a plan year only if, for the plan year, no employees accrue any additional benefits under the plan (including benefits attributable to increases in compensation or to increases in the limits of section 415), except for the minimum benefits for non-key employees required by section 416.

(4) *Qualified cash or deferred arrangements maintained by employers that include certain governmental or tax-exempt entities.* Section 401(k)(4)(B) prevents certain State and local governments and tax-exempt organizations from maintaining a qualified cash or deferred arrangement. A plan (or portion of a plan) that is a qualified cash or deferred arrangement under section 401(k) (including employee contributions and employer matching contributions that are subject to section 401(m) and are tied to elective contributions under a qualified cash or deferred arrangement) may be treated as a separate plan that satisfies section 401(a)(26) for a plan year if the following requirements are satisfied:

(i) the arrangement is maintained by an employer who has employees precluded from being eligible employees under the arrangement by reason of section 401(k)(4)(B), and

(ii) more than 95 percent of the employees of the employer who are not precluded from being eligible employees under the arrangement by section 401(k)(4)(B) benefit under the arrangement.

(5) *Certain acquisitions or dispositions*—(i) *General rule.* Rules similar to rules prescribed under section 410(b)(6)(C) apply under section 401(a)(26). Under these rules, the requirements of section 401(a)(26) are treated as satisfied for certain plans of an employer involved in an acquisition or disposition (transaction) for the transition period. The transition period begins on the date of the transaction and ends on the last day of the first plan year beginning after the date of the transaction.

(ii) *Special rule for transactions that occur in the plan year prior to the first plan year to which section 401(a)(26) applies.* Where there has been a transaction described in section 410(b)(6)(C) in the plan year prior to the first plan year in which section 401(a)(26) applies to a plan, the plan satisfies section 401(a)(26) for the transition period if the plan benefited 50 employees or 40 percent of the employees of the employer immediately prior to the transaction.

(iii) *Definition of "acquisition" and "disposition."* For purposes of this paragraph (b)(5), the terms "acquisition" and "disposition" include asset as well as stock acquisitions or dispositions.

(c) *Additional rules.* The Commissioner may, by revenue rulings, notices or other documents of general applicability, prescribe additional guidance that may be necessary or appropriate for the application of §1.401(a)(26)-1 through §1.401(a)-(26)-9.

§1.401(a)(26)-2 Minimum participation rule.

(a) *General rule.* A plan satisfies this paragraph (a) for a plan year only if the plan benefits at least the lesser of—

(1) 50 employees of the employer, or

(2) 40 percent of the employees of the employer.

(b) *Frozen plans*—(1) *Defined contribution plans.* A defined contribution plan under which no employee receives an allocation of either contributions or forfeitures for a plan year satisfies paragraph (a) of this section automatically. Thus, a discretionary profit sharing plan under which employees receive an allocation of earnings but no allocation of contributions or forfeitures for a plan year satisfies section 401(a)(26) for the plan year.

(2) *Defined benefit plans*—(i) *Frozen defined benefit plan rule.* A frozen defined benefit plan satisfies paragraph (a) of this section for a plan year automatically. Thus, a frozen defined benefit plan satisfies section 401(a)(26) for a plan year by satisfying the prior benefit structure requirements in §1.401(a)(26)-3.

(ii) *Frozen defined benefit plan.* A plan is a frozen defined benefit plan for purposes of the rule in paragraph (b)(2)(i) of this section if it is a plan under which no employees accrue an additional benefit for a plan year. A defined benefit plan is not a frozen defined benefit plan for purposes of this paragraph (b)(2) if the plan provides benefit accruals for any employee, including accruals due to increases in compensation or to increases in the limits imposed by section 415 or section 401(a)(17). However, a defined benefit plan that provides only the minimum benefits for non-key employees required by section 416 is a frozen defined benefit plan for purposes of this paragraph (b)(2).

(c) *Plan*—(1) *In general.* "Plan" means a plan described in section 401(a) that includes one or more trusts intended to be exempt from tax under section 501(a), an annuity plan described in section 403(a), or a plan described in section 403(b).

(2) *Separate asset pools are separate plans.* Each single plan within the meaning of section 414(l) is a separate plan for purposes of section 401(a)(26). See §1.414(l)-1(b). For example, if only a portion of the assets under a defined benefit plan is available, on an ongoing basis, to provide the benefits of certain employees and the remaining assets are available only in certain limited cases to provide these benefits (but are available, in all cases, for the benefits of other employees), there are two separate plans. A single plan under section 414(l) is a plan for purposes of section 401(a)(26) notwithstanding that the plan comprises separate, written plan documents and separate trusts, each of which has received separate determination letters from the Internal Revenue Service. A defined contribution plan does not constitute separate plans merely because it includes more than one trust, provides for separate accounts, permits employees to direct the investment of the amounts allocated to their accounts, or permits distribution in kind. Further, a plan does not constitute separate plans merely because assets are invested in individual insurance or annuity contracts for employees.

(d) *Disaggregation of certain plans*—(1) *Plans benefiting collectively bargained employees.* For purposes of section 401(a)(26), an employer may treat the portion of a plan that benefits employees who are included in a unit of employees covered by a collective bargaining agreement as a plan separate from the portion of a plan that benefits employees who are not included in such a collective bargaining unit. This paragraph (d)(1) applies separately to each collective bargaining agreement. Thus, for example, the portion of a plan that benefits employees included in a unit of employees covered by one collective bargaining agreement may be treated as a plan that is separate from the portion of the plan that benefits employees included in a unit of employees covered by another collective bargaining agreement.

(2) *ESOPs.* The portion of a plan that is an employee stock ownership plan described in section 4975(e)(7) (an ESOP) and the portion of the plan that is not an ESOP are treated as separate plans for purposes of section 401(a)(26). An employer may treat the rule in this paragraph (d)(2) as not applying to plan years beginning before January 1, 1990.

(3) *Plans benefiting otherwise excludable employees.* If, in accordance with §1.401(a)(26)-6(b)(1)(ii), a plan satisfies section 401(a)(26) separately with respect to the portion of a plan that benefits only employees who have failed to satisfy the highest minimum age and/or service conditions permissible under section 410(a)(1), that portion may be treated as a separate plan for purposes of section 401(a)(26).

(4) *Plans maintained by more than*

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one employer—(i) *Multiple employer plans.* If a plan benefits employees of more than one employer and those employees are not included in a unit of employees covered by one or more collective bargaining agreements, the plan is a multiple employer plan. A multiple employer plan is treated as separate plans, each of which is maintained by a separate employer and must separately satisfy section 401(a)(26) by reference only to that employer's employees.

(ii) *Multiemployer plans.* For purposes of applying the multiemployer plan exception in §1.401(a)(26)-1(b)(2)(i), the portion of a multiemployer plan that benefits employees who are included in one or more units of employees covered by one or more collective bargaining agreements and the portion of that plan that benefits employees who are not included in a unit of employees covered pursuant to any collective bargaining agreement are treated as separate plans. Under §1.401(a)(26)-1(b)(2), the portion of a multiemployer plan that benefits employees who are not included in a unit of employees covered by a collective bargaining agreement is a multiple employer plan as described in paragraph (d)(4)(i) of this section. This paragraph (d)(4)(ii) shall not apply to the extent that the special testing rule in §1.401(a)(26)-1(b)(2)(ii) applies. Also, this paragraph (d)(4)(ii) shall not apply for purposes of prior benefit structure testing under §1.401(a)(26)-3.

(5) *Defined benefit plans with other arrangements*—(i) *In general.* A defined benefit plan is treated as comprising separate plans if, under the facts and circumstances, there is an arrangement (either under or outside the plan) that has the effect of providing any employee with a greater interest in a portion of the assets of a plan in a way that has the effect of creating separate accounts. Separate plans are not created, however, merely because a partnership agreement provides for allocation among partners, in proportion to their partnership interests, of either the cost of funding the plan or surplus assets upon plan termination.

(ii) *Examples.* The following examples illustrate certain situations in which other arrangements relating to a defined benefit plan are or are not treated as creating separate plans:

Example 1. Employer A maintains a defined benefit plan under which each highly compensated employee can direct the investment of the portion of the plan's assets that represents the accumulated contributions with respect to that employee's plan benefits. In addition, by agreement outside the plan, if the product of the employee's investment direction exceeds the value needed to fund that employee's benefits, Employer A agrees to make a special payment to the participant. In this case, each separate portion of the pool of assets over which an employee has investment authority is a separate plan for the employee.

Example 2. Employer B is a partnership that maintains a defined benefit plan. The partnership agreement provides that, upon termination of the plan, a special allocation of any excess plan assets after reversion is made to the partnership on the basis of partnership share. This arrangement does not create separate plans with respect to the partners.

§1.401(a)(26)-3 Rules applicable to a defined benefit plan's prior benefit structure.

(a) *General rule.* A defined benefit plan that does not meet one of the exceptions in §1.401(a)(26)-1(b) must satisfy paragraph (c) of this section with respect to its prior benefit structure. Defined contribution plans are not subject to this section.

(b) *Prior benefit structure.* The prior benefit structure under a defined benefit plan for a plan year includes all benefits accrued to date under the plan. Each defined benefit plan has only one prior benefit structure, and all accrued benefits under the plan as of the beginning of a plan year (including benefits rolled over or transferred to the plan) are included in the prior benefit structure for the year.

(c) *Testing a prior benefit structure*—(1) *General rule.* A plan's prior benefit structure satisfies this paragraph if the plan provides meaningful benefits to a group of employees that includes the lesser of 50 employees or 40 percent of the employer's employees. Thus, a plan satisfies the requirements of this paragraph (c) if at least 50 employees or 40 percent of the employer's employees currently accrue meaningful benefits under the plan. Alternatively, a plan satisfies this paragraph if at least 50 employees and former employees or 40 percent of the employer's employees and former employees have meaningful accrued benefits under the plan.

(2) *Meaningful benefits.* Whether a plan is providing meaningful benefits, or whether employees have meaningful accrued benefits under a plan, is determined on the basis of all the facts and circumstances. This determination is intended to ensure that a plan functions as an ongoing defined benefit plan providing meaningful benefits to at least 50 employees of the employer or 40 percent of the employer's employees. A plan does not satisfy this paragraph (c) if it exists primarily to preserve accrued benefits for a small group of employees and thereby functions more as an individual plan for the small group of employees or for the employer. The relevant factors in making this determination include, but are not limited to, the following: the level of current benefit accruals; the comparative rate of accruals under the current benefit formula compared to prior rates of accrual under the plan; the projected accrued benefits under the current benefit formula compared to accrued benefits as of the close of the immediately preceding plan year; the length of time the current benefit formula has been in effect; the number of employees with accrued benefits under the plan; and the length of time the plan has been in effect. A rule for determining whether an offset plan provides meaningful benefits is provided in §1.401(a)(26)-5(d)(1).

(d) *Multiemployer plan rule.* A multiemployer plan is deemed to satisfy the prior benefit structure rule in paragraph (c)(1) of this section for a plan year if the multiemployer plan provides meaningful benefits to at least 50 employees for a plan year, or 50 employees have meaningful accrued benefits under the plan. For purposes of this paragraph, all employees benefiting under the multiemployer plan may be considered.

§1.401(a)(26)-4 Testing former employees.

(a) *Scope.* This section applies to any defined benefit plan that benefits former employees in a plan year and does not meet one of the exceptions in §1.401(a)(26)-1(b). A plan benefits former employees in a plan year only if it provides for additional benefit accruals for former employees during that plan year. Thus, for example, a plan is subject to this section for a plan year if it is amended for a plan year to provide an ad hoc cost-of-living adjustment of former employees' benefits.

(b) *Minimum participation rule for former employees.* Except as set forth

in paragraph (c) of this section, a plan that is subject to this section must benefit at least the lesser of:

(1) 50 former employees of the employer, or

(2) 40 percent of the former employees of the employer.

(c) *Special rule.* A plan satisfies the minimum participation rule in paragraph (b) of this section if the plan benefits at least 5 former employees of the employer and either:

(1) More than 95 percent of all former employees with benefits under the plan benefit under the plan for the plan year, or

(2) At least 60 percent of the former employees who benefit under the plan are not highly compensated former employees.

(d) *Excludable former employees*—(1) *General rule.* Whether a former employee is an excludable former employee for purposes of this section is determined under §1.401(a)(26)-6(c).

(2) *Exception.* Solely for purposes of paragraph (c) of this section, the rule in §1.401(a)(26)-6(c)(4) (regarding vested accrued benefits eligible for mandatory distribution) does not apply to any former employee having a vested accrued benefit. Thus, a former employee who has a vested accrued benefit is not an excludable former employee merely because that vested accrued benefit does not exceed $3,500.

§1.401(a)(26)-5 Employees who benefit under a plan.

(a) *Benefiting under a plan.* Except as provided in paragraphs (b) through (d) of this section, an employee is treated as benefiting under a plan for a plan year only if the employee actually accrues a benefit for the plan year.

(b) *Section 401(k) and section 401(m).* An employee is treated as benefiting under a plan that is subject to section 401(k) for a plan year if the employee is an eligible employee under the plan for the plan year. This is the case without regard to whether the employee has a benefit under the plan and without regard to whether the employee makes elective contributions under the plan for the year. Similarly, an employee is treated as benefiting under a plan that accepts after-tax employee contributions subject to section 401(m) or that provides matching contributions subject to section 401(m) if the employee is an eligible employee for the year.

(c) *Certain plan limits.* An employee is treated as benefiting under a plan for a plan year if the employee both satisfies all of the applicable conditions to accruing a benefit under the plan for the plan year, and fails to accrue a benefit merely because of a uniformly applicable benefit or contribution limit under the plan including statutory limits under section 415. The following example illustrates the rule of this paragraph (c):

Example. Defined benefit plan Y provides for an annual benefit for life equal to 1 percent times final average compensation times years of service. Only an employee's first 30 years of service, however, are taken into account under this formula. For the current year, employee Z is age 60 and has performed over 30 years of service. Employee Z is treated as benefiting under the plan for the year even though Z is not credited with an additional year under the plan because of the 30-year limit on years of service taken into account under the plan.

(d) *Sequential or concurrent benefit offset arrangements*—(1) *In general.* An employee is treated as accruing a benefit under a plan that includes an offset or reduction of benefits that satisfies either paragraph (d)(2) or (d)(3) of this section if either the employee accrues a benefit under the plan for the year, or the employee would have accrued a benefit if the offset or reduction portion of the benefit formula were disregarded. In addition, an employee is treated as accruing a meaningful benefit for purposes of prior benefit structure testing under §1.401(a)(26)-3 if the employee would have accrued a meaningful benefit if the offset or reduction portion of the benefit formula were disregarded.

(2) *Offset by sequential or grandfathered benefits.* An offset or reduction of benefits under a defined benefit plan satisfies this paragraph (d)(2) if the benefit formula provides that an employee will not accrue additional benefits under the current portion of the benefit formula until the employee has accrued, under such portion, a benefit in excess of such employee's benefit under one or more formulas in effect for prior years that are based wholly on prior years of service. The prior benefit may have accrued under the same or a separate plan, may be provided under the same or a separate plan and may relate to service with the same or prior employers. Benefits will not fail to be treated as based wholly on prior years if they are based, directly or indirectly, on compensation earned after such prior years (including compensation earned in the current year), if they are adjusted to reflect increases in the section 415 limitations, or if they are increased to provide an ad hoc cost of living adjustment designed to adjust, in whole or in part, for inflation. Furthermore, benefits do not fail to be treated as based wholly on prior years merely because the benefits (e.g., early retirement benefits) are subject to an age or years-of-service condition and, in applying the condition or conditions, the current and prior years are taken into account.

(3) *Concurrent benefit offset arrangements*—(i) *General rule.* An offset or reduction of benefits under a defined benefit plan satisfies the requirements of this paragraph (d)(3) if the benefit formula provides a benefit that is offset or reduced by contributions or benefits under another plan that is maintained by the same employer and the following additional requirements are met:

(A) The contributions or benefits under a plan that are used to offset or reduce the benefits under the positive portion of the formula being tested accrued under such other plan;

(B) The employees who benefit under the formula being tested also benefit under the other plan on a reasonable and uniform basis; and

(C) The contributions or benefits under the plan that are used to offset or reduce the benefits under the formula being tested are not used to offset or reduce that employee's benefits under any other plan or any other formula.

(ii) *Special rules for certain section 414(n) recipient employers.* The same employer requirement in the concurrent benefit offset rule in paragraph (d)(3)(i) of this section is waived for certain section 414(n) recipient employers. Under this exception, an employer-recipient (within the meaning of sections 414(n) and (o)) may treat contributions or benefits to a plan maintained by a leasing organization as contributions or benefits accrued under the recipient organization plan provided the following requirements are met: the employer-recipient maintains a plan covering

leased employees (which employees are treated as employees of the employer-recipient within the meaning of sections 414(n)(2) and 414(o)(2)); the leased employees are also covered under a plan maintained by the leasing organization; and contributions or benefits under the recipient plan are offset or reduced by the contributions or benefits under the leasing organization plan that are attributable to service with the recipient organization. Also, for purposes of the benefiting condition requirement in paragraph (d)(3)(i)(B) of this section, the employees of the recipient who are not leased from the leasing organization are not required to benefit under the plan of the leasing organization.

§1.401(a)(26)-6 Excludable employees.

(a) *In general.* Except as specifically provided otherwise in this section, in applying section 401(a)(26) with respect to either employees, former employees, or both employees and former employees, as applicable, all employees other than excludable employees described in paragraph (b) of this section, all former employees other than excludable former employees described in paragraph (c) of this section, or both, as the case may be, must be taken into account. Also, except as specifically provided otherwise in this section, the rules of this section are applied by reference only to the particular plan and must be applied on a uniform and consistent basis.

(b) *Excludable employees.* An employee is an excludable employee if the employee is covered by one or more of the following exclusions:

(1) *Minimum age and service exclusions*—(i) *In general.* An employee who is excluded from consideration under section 410(b)(4)(A) (relating to employees who do not participate in the plan by reason of not satisfying certain minimum age and service requirements) for purposes of determining whether a plan satisfies section 410(b) may be treated as an excludable employee.

(ii) *Coverage extended to otherwise excludable employees.* An employee who would be excludable under paragraph (b)(1)(i) of this section but for the fact that the employee (or another employee with the same age and service) is not excluded from coverage under the plan (an otherwise excludable employee) may nevertheless be treated as an excludable employee if each of the following conditions is satisfied:

(A) The plan under which the otherwise excludable employees benefit also benefits employees who are not otherwise excludable.

(B) The plan under which the otherwise excludable employees benefit satisfies section 401(a)(26), both by reference only to otherwise excludable employees and by reference only to employees who are not otherwise excludable.

(C) The contributions or benefits provided to the otherwise excludable employees (expressed as percentages of compensation) are not greater than the contributions or benefits provided to the employees who are not otherwise excludable under the plan.

(D) No highly compensated employee is included in the group of otherwise excludable employees for more than one plan year.

(iii) *Examples.* The following examples illustrate some of the minimum-age-and-service exclusion requirements:

Example 1. Employer X maintains a defined contribution plan, Plan X, under which employees who have not completed 1 year of service are not eligible to participate. Employer X has six employees. Two of the employees participate in Plan X. The other four employees have not completed 1 year of service and are therefore not eligible to participate in Plan X. The four employees who have not completed 1 year of service are excludable employees and may be disregarded for purposes of applying the minimum participation test. Therefore, Plan X satisfies section 401(a)(26) because both of the two employees who must be considered are participants in Plan X.

Example 2. Employer Y has 100 employees and maintains two plans, Plan 1 and Plan 2. Plan 1 provides that employees who have not completed 1 year of service are not eligible to participate. Plan 2 has no minimum age or service requirement. Twenty of Y's employees do not meet the minimum service requirement under Plan 1. Each plan satisfies the ratio test under section 410(b)(1)(B). In testing Plan 1 to determine whether it satisfies section 401(a)(26), the 20 employees not meeting the minimum age and service requirement under Plan 1 are treated as excludable employees. In testing Plan 2 to determine whether it satisfies section 401(a)(26), no employees are treated as excludable employees because Plan 2 does not have a minimum age or service requirement.

(2) *Certain air pilots.* An employee who is excluded from consideration under section 410(b)(3)(B) (relating to certain air pilots) may be treated as an excludable employee.

(3) *Certain nonresident aliens.* An employee who is excluded from consideration under section 410(b)(3)(C) (relating to certain nonresident aliens) may be treated as an excludable employee.

(4) *Employees covered pursuant to a collective bargaining agreement*—(i) *In general.* An employee who is excluded from consideration under section 410(b)(3)(A) (exclusion for employees included in a unit of employees covered by a collective bargaining agreement) with respect to a plan may be treated as an excludable employee. This rule may be applied separately to each collective bargaining agreement. See §1.401(a)(26)-1(b)(2)(iii) with respect to whether employees are covered pursuant to a collective bargaining agreement.

(ii) *Professional employees covered pursuant to a collective bargaining agreement.* Paragraph (b)(4)(i) of this section does not apply in the case of a collective bargaining agreement if more than 2 percent of the employees of the employer who are covered pursuant to that agreement are professionals as defined in §1.401(a)(26)-8(k).

(5) *Employees not covered pursuant to a collective bargaining agreement.* When testing a plan that benefits only employees who are included in a group of employees who are covered pursuant to a collective bargaining agreement, an employee who is not included in the group of employees who are covered by the collective bargaining agreement may be treated as an excludable employee.

(6) *Examples.* The following examples illustrate the excludable employee rules that relate to employees covered pursuant to collective bargaining agreements. For purposes of these examples assume that no other exclusion rules are applicable.

Example 1. Employer W has 70 collectively bargained employees and 30 non-collectively bargained employees. Employer W maintains Plan W, which benefits only the 30 non-collectively bargained employees. The 70 collectively bargained employees may be treated as excludable employees and thus may be disregarded in applying section 401(a)(26) to Plan W.

Example 2. Assume the same facts as Example 1, except that the Commissioner has determined that the employee representative is not a bona fide employee representative under section 7701(a)(46) and thus there are no "collectively bargained employees." In this case, all employees of W must be considered in determining whether section 401(a)(26) is met.

Example 3. Employer X has 30 collectively bargained employees and 70 non-collectively bargained employees. Employer X maintains Plan X, which benefits only the 30 collectively bargained employees. Employer X may treat the non-collectively bargained employees as excludable employees and disregard them in applying section 401(a)(26) to the collectively bargained plan.

Example 4. Assume the same facts as *Example 3*, except that the Commissioner has determined that the employee representative is not a bona fide employee representative under section 7701(a)(46) and thus there is no recognized collective bargaining agreement. In this case, Employer X may not treat the non- collectively bargained employees of X as excludable employees.

Example 5. Assume the same facts as *Example 3*, except that 3 percent of the 30 collectively bargained employees are professionals. In this case, Employer X may not treat the non-collectively bargained employees of X as excludable employees.

Example 6. Employer Y has 100 collectively bargained employees. Thirty of Y's employees are represented by Collective Bargaining Unit 1 and covered under Plan 1. Seventy of Y's employees are represented by Collective Bargaining Unit 2 and covered under Plan 2. For purposes of testing Plan 1, the employees of Collective Bargaining Unit 2 may be treated as excludable employees. Similarly, for purposes of testing Plan 2, the employees of Collective Bargaining Unit 1 may be treated as excludable employees.

(7) *Certain terminating employees*—(i) *General rule.* An employee may be treated as an excludable employee for a plan year if all of the following requirements are met:

(A) The employee does not benefit under the plan for the plan year;

(B) The employee is an eligible participant under the plan;

(C) The plan has a minimum period of service requirement or a requirement that the employee be employed on the last day of the plan year (last-day requirement) for an employee to accrue a benefit or receive an allocation for the plan year;

(D) The employee fails to accrue a benefit under the plan solely because of the failure to satisfy the minimum requirement; and

(E) The employee terminates employment during the plan year with not more than 500 hours of service or a lesser number of hours that the plan provides, and the employee is not employed on the last day of the plan year.

(ii) *Hours of service, etc.* For purposes of this paragraph (b)(7), the term "hour of service" has the same meaning as set forth in 29 CFR §2530.200b-2 under the general method of crediting service for the employee. If one of the equivalencies set forth in 20 CFR §2530.200b-3 is used for crediting service under the plan, the 500-hour requirement must be adjusted accordingly.

(c) *Excludable former employees*—(1) *Rules analogous to excludable employee rules.* A former employee is an excludable former employee if the employee was excluded (or would have been excludable if section 401(a)(26) had been in effect) from consideration during the plan year that the employee terminated services as an employee under any of the following excludable employee rules:

(i) Paragraph (b)(1) of this section (relating to employees not satisfying certain minimum age and service requirements, and to coverage extended to otherwise excludable employees);

(ii) Paragraph (b)(2) of this section (relating to certain air pilots);

(iii) Paragraph (b)(3) of this section (relating to certain nonresident aliens). A former employee who would be an excludable employee under paragraph (b)(3) of this section in the year being tested is also treated as an excludable former employee.

(iv) Paragraph (b)(4) of this section (relating to certain employees covered pursuant to collective bargaining agreements); or

(v) Paragraph (b)(5) of this section (relating to certain employees not covered pursuant to a collective bargaining agreement).

(2) *Pre-1984 former employees.* A former employee who did not have an hour of service after calendar year 1983, may be treated as an excludable former employee.

(3) *Pre-retirement former employees.* A former employee who terminated employment prior to the earliest retirement date specified in the plan and applicable to that employee may be treated as an excludable employee.

(4) *Vested accrued benefits eligible for mandatory distribution.* A former employee may be treated as an excludable former employee if the present value of the former employee's vested accrued benefit does not exceed $3,500. This determination is made in accordance with the rules of sections 411(a)(11) and 417(e).

(d) *Certain police or firefighters.* An employer may apply section 401(a)(26) separately with respect to any classification of qualified public safety employees for whom a separate plan is maintained. Thus, for purposes of testing a separate plan covering a class of qualified public safety employees, all employees who are not in that classification are treated as excludable employees. Also, such employees need not be taken into account in determining whether or not any other plan satisfies section 401(a)(26). For purposes of this paragraph (d), "qualified public safety employee" means any employee of any police department or fire department organized and operated by a State or political subdivision if the employee provides police protection, firefighting services, or emergency medical services for any area within the jurisdiction of a State or political subdivision.

§1.401(a)(26)-7 Testing methods.

(a) *Testing on each day of the plan year.* A plan satisfies section 401(a)(26) for a plan year only if the plan satisfies section 401(a)(26) on each day of the plan year. An employee benefits on a day if the employee is a participant for such day and the employee benefits under the plan for the year under the rules in §1.401(a)(26)-5.

(b) *Simplified testing method.* A plan is treated as satisfying the requirements of paragraph (a) of this section if it satisfies section 401(a)(26) on any single plan day during the plan year, but only if that day is reasonably representative of the employer's workforce and the plan's coverage. A plan does not have to be tested on the same day each plan year.

(c) *Retroactive correction.* If a plan fails to satisfy section 401(a)(26) for a plan year, the plan may be amended by the last day of the plan year to retroactively satisfy section 401(a)(26), by expanding coverage, improving benefits or contributions, or modifying eligibility conditions under the plan. Plans that are merged by the end of the plan year are not treated as failing to satisfy section 401(a)(26) solely because the plans failed to satisfy section 401(a)(26) prior to the merger. The need to retroactively amend to satisfy section 401(a)(26) does not constitute a basis for eliminating or reducing a benefit in violation of section 411(d)(6). The rule of this paragraph (c) may be illustrated by the following example.

Example. Assume that an employer with 500 employees maintains two defined contribution plans. Plan A benefits 45 employees. Plan B benefits 50 employees. Immediately before the end of the year, the employer expands coverage under Plan A to benefit 20 more employees retroactively for the plan year. Thus, Plan A satisfies paragraph (a) of this section for the plan year. Alternatively, before the end of the year, or later if a later period is applicable under section 401(b), the employer could merge Plan A with Plan B to satisfy section 401(a)(26).

§1.401(a)(26)-8 Definitions.

The following definitions apply for purposes of section 401(a)(26) and the regulations thereunder:

(a) *Collective bargaining agreement.* "Collective bargaining agreement" means an agreement that the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and the employer that satisfies §301.7701-17T. Employees described in section 413(b)(8) who are employees of the union or the plan and are treated as employees of an employer are not employees covered pursuant to a collective bargaining agreement for purposes of section 401(a)(26) unless the employees are actually covered pursuant to such an agreement.

(b) *Defined benefit plan.* "Defined benefit plan" means a defined benefit plan within the meaning of section 414(j).

(c) *Defined contribution plan.* "Defined contribution plan" means a defined contribution plan within the meaning of section 414(i).

(d) *Employee.* "Employee" means an individual who currently performs services for the employer and is either a common-law employee of the employer or a self-employed individual treated as an employee pursuant to section 401(c)(1). "Employee" also includes a leased employee who is treated as an employee of the employer-recipient under the provisions of section 414(n)(2) or section 414(o)(2), other than individuals who are excluded by reason of section 414(n)(5). Individuals that an employer treats as leased employees under section 414(n), pursuant to the requirements of section 414(o), are leased employees for purposes of this paragraph (d).

(e) *Employer.* "Employer" means, except as specifically provided otherwise in the regulation under section 401(a)(26), the employer maintaining the plan and those employers aggregated with the employer under sections 414(b), (c), (m), or (o). An individual who owns the entire interest of an unincorporated trade or business is treated as an employer. Also, a partnership is treated as the employer of each partner and each employee of the partnership.

(f) *Former employee.* "Former employee" means an individual who was an employee and terminated from service for the employer. An individual becomes a former employee on the day after the day on which the individual terminates from service for the employer. Thus, an employee who terminates from service for an employer during a plan year is both an employee (with respect to any benefits attributable to the individual as an employee) and a former employee (with respect to any benefits attributable to the individual as a former employee) for the plan year.

(g) *Highly compensated employee.* "Highly compensated employee" means a highly compensated employee within the meaning of section 414(q).

(h) *Highly compensated former employee.* "Highly compensated former employee" means a highly compensated former employee within the meaning of section 414(q).

(i) *Multiemployer plan.* "Multiemployer plan" means a multiemployer plan within the meaning of section 414(f).

(j) *Nonhighly compensated employee.* "Nonhighly compensated employee" means an employee who is not a highly compensated employee.

(k) *Professional.* "Professional" means professional as defined in §1.410(b)-9(g).

§1.401(a)(26)-9 Effective dates and transition rules.

(a) *In general.* Except as provided in paragraphs (b), (c), and (d) of this section, section 401(a)(26) and the regulations thereunder apply to plan years beginning after December 31, 1988.

(b) *Transition rules*—(1) *Governmental plans and certain section 403(b) annuities.* Section 401(a)(26) is treated as satisfied for plan years beginning before January 1, 1993, in the case of a plan maintained by the government of any State or political subdivision thereof, or by any agency or instrumentality of either of the foregoing. Also, a section 403(b) plan for employees who perform services for an educational organization described in section 170(b)(1)(A)(ii), by an employer which is a State, a political subdivision of a State, or an agency or instrumentality of any one or more of the foregoing is deemed to satisfy section 401(a)(26) for plan years beginning before January 1, 1993.

(2) *Early retirement "window-period" benefits.* Early retirement benefits available under a plan only to employees who retire within a limited period of time, not to exceed one year, are treated as satisfying section 401(a)(26) if such benefits are provided under plan terms that were adopted and in effect on or before March 14, 1989.

(3) *Employees who do not benefit because of a minimum-period-of-service requirement or a last-day requirement.* For the first plan year beginning after December 31, 1988, and before January 1, 1990, employees who are eligible to participate under the plan and who fail to accrue a benefit solely because of the failure to satisfy either a minimum-period-of-service requirement of 1000 hours of service or less or a last-day requirement may be treated as benefiting under the plan.

(4) *Certain plan terminations*—(i) *In general.* Except as provided in paragraph (b)(4)(ii) of this section, if a plan terminates after section 401(a)(26) becomes effective with respect to the plan (as determined under paragraph (a) of this section), the plan is not treated as a qualified plan upon termination unless it complies with section 401(a)(26) and the regulations thereunder (to the extent they are applicable) for all periods for which section 401(a)(26) is effective with respect to the plan.

(ii) *Exception.* Notwithstanding paragraphs (a) and (b)(4)(i) of this section, a plan does not fail to be treated as a qualified plan upon termination merely because the plan fails to satisfy the requirements of section 401(a)(26) and the regulations thereunder if the plan is terminated with a termination date on or before December 31, 1989, and either of the following conditions is satisfied:

(A) In the case of a defined benefit plan, no highly compensated employee has an accrued benefit under the plan exceeding the lesser of either the benefit the employee had accrued as of the close of the last plan year beginning before January 1, 1989, or the benefit the employee would have accrued as of the close of the last plan year under the terms of the plan in effect and applicable with respect to the employee on December 13, 1988.

(B) In the case of a defined contribution plan, no highly compensated employee receives a contribution allocation for any plan year beginning after December 31, 1988. For this purpose, a contribution allocation with respect to an employee for a plan year beginning before January 1, 1989, may be treated as a contribution allocation for a plan year beginning after December 31, 1988, if the allocation for the prior year exceeds the allocation that the employee would have received for such year under the terms of the plan in effect and applicable with respect to the employee on December 13, 1988. An allocation of forfeitures to highly compensated employees with respect to contributions made for plan years beginning before January 1, 1988, does not cause a defined contribution plan to fail to satisfy the conditions of this paragraph (b)(4)(ii)(B).

(c) *Waiver of excise tax on reversions*—(1) *In general.* Pursuant to section 1112(e)(3) of the Tax Reform Act of 1986 (TRA '86), if certain conditions are satisfied, a waiver of the excise tax under section 4980 applies with respect to any employer reversion that occurs by reason of the termination or merger of a plan before the first year to which section 401(a)(26) applies to the plan. In general, the applicable conditions are that the plan must have been in existence on August 16, 1986; that if section 401(a)(26) was in effect for the plan year including August 16, 1986, the plan would have failed to satisfy the requirements of section 401(a)(26) and would have continued to fail the requirements at all times thereafter; that the plan satisfies the applicable conditions in paragraph (b)(4)(ii)(A) or (B) of this section; and that certain requirements regarding asset or liability transfers and mergers and spinoffs involving the plan after August 16, 1986, are satisfied.

(2) *Termination date.* An employer reversion with respect to a plan is eligible for the section 4980 excise tax waiver only if the employer reversion occurs by reason of the termination of the plan with a termination date prior to the first plan year for which section 401(a)(26) applies to the plan. Solely for purposes of this waiver, the employer reversion is treated as satisfying this paragraph (c)(2) even though the plan's termination date is during the first plan year for which section 401(a)(26) applies to the plan if the plan's termination date is on or before May 31, 1989. If the termination date occurs in the first plan year for which section 401(a)(26) applied to the plan and the employer receives a reversion that is eligible for the waiver of the section 4980 tax, the plan is subject to the interest rate restriction set forth in section 1112(e)(3)(B) of TRA '86 as amended.

(3) *Failure to satisfy section 401(a)(26).* An employer reversion with respect to a plan is eligible for the excise tax waiver only if the plan was in existence on August 16, 1986, and, if section 401(a)(26) had applied to the plan for the plan year including such date, the plan would have failed to satisfy section 401(a)(26) for the plan year and continuously thereafter until the plan's termination or merger. For purposes of this paragraph (c)(3), a plan is treated as though it would have failed to satisfy section 401(a)(26) before such section actually applied to the plan only if the plan (as defined under section 414(l)) failed to benefit at least the lesser of 50 employees or 40 percent of the employer's employees. In general, this determination is to be made on the basis of only the applicable statutory provisions, without regard to the regulations under section 401(a)(26). Thus, for example, the prior benefit structure rules in §1.401(a)(26)-3 do not apply in determining whether a plan would have failed to satisfy section 401(a)(26) for plan years beginning prior to the effective date of section 401(a)(26) with respect to the plan.

(d) *Special rule for collective bargaining agreements.* In the case of a plan maintained pursuant to one or more collective bargaining agreements (as defined in §1.401(a)(26)-8(a)) that were ratified before March 1, 1986, section 401(a)(26) and the regulations thereunder shall not apply to plan years beginning before the earlier of—

(1) January 1, 1991, or

(2) The later of—

(i) January 1, 1989, or

(ii) The date on which the last of such collective bargaining agreements terminates. For purposes of this paragraph (d), any extension or renegotiation of any collective bargaining agreement that is ratified after February 28, 1986, is disregarded in determining the date on which such collective bargaining agreement terminates.

Fred T. Goldberg, Jr.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on May 10, 1990, 8:45 a.m., and published in the issue of the Federal Register for May 14, 1990, 55 F.R. 19935)

Notice of Proposed Rulemaking

Nondiscrimination Requirements for Qualified Plans

EE-61-88

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under sections 401(a)(4) and 410(b) of the Internal Revenue Code. The proposed regulations interpret both the section 401(a)(4) requirement that contributions or benefits provided under a tax-qualified retirement plan may not discriminate in favor of highly compensated employees and the related section 410(b) minimum coverage requirements. These two sections form a coordinated nondiscrimination rule that prohibits a qualified retirement plan from being designed or operated to favor highly compensated employees. This document also contains related proposed amendments to the existing regulations under sections 401(a)(4), 401(a)(5), and 411(d)(6).

These proposed regulations are being issued in conjunction with three other sets of regulations that modify previously proposed regulations concerning tax-qualified retirement plans. Because these proposed regulations under section 401(a)(4) set out for the first time comprehensive tests for nondiscrimination, it has been possible to simplify the legal and administrative requirements contained in the related regulations.

These proposed regulations reflect changes made by the Tax Reform Act of 1986 and by the Technical and Miscellaneous Revenue Act of 1988. These regulations will provide the public with guidance necessary to comply with the law and will affect sponsors of and participants in tax-qualified retirement plans.

DATES: Written comments must be received by July 13, 1990. Requests to speak (with outlines of oral comments) at a public hearing scheduled for Wednesday, September 26, 1990, at 10:00 a.m., and continuing at 10:00 a.m. each day, if necessary, on Thursday, September 27, 1990, and Friday, September 28, 1990, must be received by Wednesday, September 12, 1990. See the notice of hearing published elsewhere in *** [Announcement 90-78, 1990-23 I.R.B. 50. These regulations are generally proposed to be effective for plan years beginning on or after January 1, 1991.

ADDRESSES: Send comments, requests to appear at the public hearing and outlines to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Attention: CC:CORP:T:R (EE-61-88), Room 4429, Washington, D.C. 20224. The public hearing will be held in the IRS Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Ave., N.W., Washington, D.C.

SUPPLEMENTARY INFORMATION:

Statutory Authority

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 401(a)(4) and 410(b) of the Internal Revenue Code of 1986 (Code). These amendments are proposed to reflect changes made by sections 1111, 1112, and 1114 of the Tax Reform Act of 1986 [Pub. L. 99-514, 1986-3 C.B. (Vol. 1)]. These regulations are to be issued under the authority contained in sections 401(a)(4), 401(a)(5), 401(l), 410(b), 411(d), 411(e) and 7805 of the Code.

Overview

Although section 401(a)(4) and its predecessors have served for decades as the cornerstone of the requirement that tax-qualified retirement plans not discriminate in favor of highly compensated employees, comprehensive regulations under section 401(a)(4) have never been issued. Comprehensive guidance is now required in order to consolidate and simplify existing rules, to reflect the statutory provisions and legislative history of the Tax Reform Act of 1986 (TRA '86), and to provide taxpayers with an integrated framework for applying the nondiscrimination provisions of the Code.

Comprehensive guidance under section 401(a)(4) is especially important at this time because of the significant changes made by TRA '86 to many fundamental nondiscrimination rules. In TRA '86, Congress amended the minimum coverage rules (including the enactment of the average benefit percentage test), revised the social security integration rules (as reflected in the new permitted disparity rules of section 401(l)), and added section 414(s) (relating to the definition of compensation), section 401(a)(26) (imposing minimum participation requirements), and section 401(a)(17) (limiting the amount of compensation that a plan may take into account). Guidance is needed to provide taxpayers with a framework for applying these new provisions. The proposed regulations are intended to provide this framework.

In addition, the legislative history of TRA '86 specifically directs that existing guidance under section 401(a)(4), such as the comparability analysis of Rev. Rul. 81-202, 1981-2 C.B. 93, be modified to reflect the statutory changes. The proposed regulations therefore modify the rules in Rev. Rul. 81-202 in a number of important respects. Some of the modifications reflect statutory changes, such as the new permitted disparity rules. Other modifications reflect concerns expressed in the TRA '86 legislative history. These latter modifications require that comparability analysis take into account both the rate at which benefits accrue and the contingent nature of certain benefits.

The development of comprehensive guidance under section 401(a)(4) has also provided an opportunity to rethink and revisit regulations under many other provisions that relate to nondiscrimination. In the past, the absence of comprehensive guidance under section 401(a)(4) resulted in uncertainty about the meaning and application of the nondiscrimination rules and encouraged plan designs tailored to minimize benefits for nonhighly compensated employees. This, in turn, resulted in numerous additional statutory provisions and regulations intended to curb the potential for discrimination. Thus, for example, one reason Congress enacted the minimum participation rules of section 401(a)(26) was to curtail the use of multiple plan arrangements that deliver minimal benefits to nonhighly compensated employees. As a result, complex regulations were proposed under section 401(a)(26) in an effort to curtail the ability to engage in these practices.

Development of these proposed regulations, including the modifications to Rev. Rul. 81-202, has made it possible to simplify many secondary nondiscrimination rules. The proposed regulations are therefore issued in conjunction with three other proposed regulations, each of which simplifies rules previously proposed. For example, issuance of more comprehensive comparability rules has made possible substantial simplification of the section 401(a)(26) regulations, thereby reducing administrative burdens for many plan sponsors. Similarly, the proposed regulations simplify the existing restrictions on distributions upon early termination with the result that distributions to highly compensated employees are now restricted in far fewer cases without sacrificing the protection afforded other employees.

The new rules proposed under section 401(a)(4) have also permitted simplification of the permitted disparity rules under section 401(l), the definition of compensation under section 414(s), the minimum coverage requirements of section 410(b), and the nondiscrimination tests of section 401(k) and (m).

Approach Taken in Drafting

The proposed regulations have been drafted with the objective of providing guidance that is simple, clear, and administrable. A number of design-based safe harbors are provided, including safe harbors for unit credit, flat benefit, and target benefit plans. These safe harbors are intended to ensure that large numbers of qualified plans will be able to satisfy section 401(a)(4) on the basis of plan design, without resort to specific employee data.

In addition, the proposed regulations contain a number of general anti-abuse rules based on facts and circumstances. For example, the proposed regulations apply an anti-abuse standard to grants of past service credit. Quantification of these rules was rejected because of the administrative complexity quantification would impose on plan sponsors.

Relationship to Previously Published Guidance

The proposed regulations articulate and modify many of the principles and concepts previously developed in related regulations, revenue rulings, and administrative procedures. For example, the proposed regulations generally continue to allow use of a projected benefits method for testing defined benefit plans, to permit aggregation of plans and the imputation of disparity permitted under section 401(l), and to permit defined benefit plans to be tested on the basis of contributions and defined contribution plans to be tested on the basis of benefits.

These principles and concepts have been modified to reflect statutory changes made by TRA '86, such as enactment of the average benefit percentage test under section 410(b) and the permitted disparity rules of section 401(l), and to reflect the Congressional intent embodied in the legislative history of that Act. For example, defined benefit plans that do not fall within specified safe harbors must now satisfy section 401(a)(4) with respect to accrual or allocation rates, and projected benefit methods may not be used to demonstrate the comparability of defined benefit and defined contribution plans.

Overview of Section 401(a)(4) Nondiscrimination Rules

Section 401(a)(4) provides that a plan is a qualified plan only if the contributions or the benefits provided under the plan do not discriminate in favor of highly compensated employees. The rules in the proposed regulations are intended to be the exclusive rules for determining whether this requirement is met. A plan therefore will satisfy section 401(a)(4) only if it complies both in form and in operation with the rules in the proposed regulations.

Section 1.401(a)(4)-1 of the proposed regulations sets forth the three requirements a plan must meet to satisfy section 401(a)(4). The first requirement is that either the contributions or the benefits provided under the plan must be nondiscriminatory in amount. As under existing practice, a plan generally is permitted to satisfy this requirement on the basis of either contributions or benefits, regardless of whether the plan is a defined contribution plan or a defined benefit plan. Thus, a plan is not required to establish nondiscrimination in amount with respect to both the contributions and the benefits provided.

The second requirement is that the benefits, rights, and features provided under the plan must be available to employees in the plan in a nondiscriminatory manner. The benefits, rights, and features subject to this requirement are the optional forms of benefit (such as retirement annuities and single sum payments), ancillary benefits (such as disability benefits), and other rights and features (such as loans and investment options) available to employees under the plan.

The third requirement is that the effect of the plan in certain special circumstances must be nondiscriminatory. The special circumstances subject to this requirement include plan amendments, grants of past service credit, and plan terminations.

Besides setting forth these three requirements, §1.401(a)(4)-1 of the proposed regulations provides rules on how these requirements are applied.

1. *Nondiscrimination in Amount of Contributions or Benefits*

The first requirement a plan must satisfy is that either the contributions or the benefits provided under the plan must be nondiscriminatory in amount. Section 1.401(a)(4)-2 of the proposed regulations provides rules for determining whether the contributions provided under a plan are nondiscriminatory in amount. Section 1.401(a)(4)-3 of the proposed regulations provides rules for determining whether the benefits provided under a plan are nondiscriminatory in amount. Rules for converting contributions under a defined contribution plan into equivalent benefits and for converting benefits under a defined benefit plan into equivalent contributions are set forth in §1.401(a)(4)-8 of the proposed regulations.

A defined contribution plan generally will satisfy the nondiscriminatory amount requirement by showing that the contributions provided under the plan are nondiscriminatory in amount under §1.401(a)(4)-2 of the proposed regulations. Except in the case of an employee stock ownership plan or a plan subject to section 401(k) or (m), a defined contribution plan also is permitted to satisfy the nondiscriminatory amount requirement by showing that the equivalent benefits provided under the plan are nondiscriminatory in amount under §1.401(a)(4)-3 of the proposed regulations.

A defined benefit plan generally will satisfy the nondiscriminatory amount requirement by showing that the employer-provided benefits under the plan are nondiscriminatory in amount under §1.401(a)(4)-3 of the proposed regulations. A defined benefit plan also is permitted to satisfy the nondiscriminatory amount requirement by showing that the equivalent contributions provided under the plan are nondiscriminatory in amount under §1.401(a)(4)-2 of the proposed regulations.

Plans may use certain alternative methods to demonstrate that contributions or benefits are nondiscriminatory in amount. For example, plans may satisfy §§1.401(a)(4)-2 or 1.401(a)(4)-3 on an aggregated or restructured basis, using rules contained in §1.401(a)(4)-9. The proposed regulations also permit plans with multiple formulas to satisfy §§1.401(a)(4)-2 or 1.401(a)(4)-3 on the basis of each separate formula. In addition, §1.401(a)(4)-1(c)(6) of the proposed regulations provides that most collectively bargained plans automatically satisfy section 401(a)(4). Finally, §1.401(a)(4)-8 provides safe harbor testing methods for target benefit

plans and for defined benefit plans that are part of a floor-offset arrangement.

a. *Nondiscrimination in Amount of Contributions*

Section 1.401(a)(4)-2 of the proposed regulations provides rules for determining whether the contributions provided under a plan are nondiscriminatory in amount. The section provides two safe harbor tests for defined contribution plans. The first safe harbor is design-based and permits a defined contribution plan with a uniform allocation formula to satisfy §1.401(a)(4)-2 without calculating allocation rates for individual employees. The second safe harbor permits a defined contribution plan with a uniform allocation formula weighted for age or service to satisfy §1.401(a)(4)-2 if the average rate of allocations for highly compensated employees under the plan does not exceed the average rate of allocations for nonhighly compensated employees under the plan.

Plans (other than plans subject to section 401(k) or (m)) that do not satisfy one of these safe harbors generally comply with §1.401(a)(4)-2 only if no highly compensated employee under the plan has an allocation rate that exceeds that of any nonhighly compensated employee under the plan. In determining allocation rates, the disparity permitted under section 401(l) may be taken into account by a plan to which section 401(l) is otherwise available.

The proposed regulations permit an employer to treat employees with allocation rates within a narrow range selected by the employer as having the same allocation rate for purposes of satisfying the general test. Under this rule, each employee is treated as having an allocation rate equal to the midpoint of the range selected. The purpose of this rule is to level out small variations in individual allocation rates that do not arise through plan design, without expanding the disparity otherwise permitted under section 401(l). The rule is therefore limited to situations in which highly and nonhighly compensated employees have allocation rates that are dispersed throughout the selected range in a reasonably comparable manner. A similar rule is provided for grouping accrual rates in §1.401(a)(4)-3 of the proposed regulations.

Plans subject to section 401(k) or (m) must satisfy the special rules provided for them in §1.401(a)(4)-2(d). These rules incorporate by reference the requirements of section 401(k) with respect to the amount of elective contributions under a qualified cash or deferred arrangement and the requirements of section 401(m) with respect to the amount of employee and matching contributions. In addition, the rules explain how to satisfy certain conditions that apply to nonelective contributions under the section 401(k) and (m) regulations in the case of a plan that uses qualified nonelective contributions to satisfy the actual deferral percentage test or the actual contribution percentage test.

The proposed regulations treat nonqualified cash or deferred arrangements as plans subject to section 401(k), but require them to satisfy the nondiscriminatory amount requirement of §1.401(a)(4)-1(b)(2) without regard to the special rules for plans subject to sections 401(k) and (m). This treatment follows the approach taken in the regulations under sections 401(k) and (m).

b. *Nondiscrimination in Amount of Benefits*

Section 1.401(a)(4)-3 of the proposed regulations provides the basic rules for determining whether a plan is nondiscriminatory with respect to the amount of benefits. Generally, these rules apply to defined benefit plans. They may, however, also be applied to defined contribution plans in testing nondiscrimination on the basis of equivalent benefits.

The section contains three safe harbors under which a plan is considered nondiscriminatory with respect to the amount of benefits. Two of the safe harbors are design-based and require no determination of the benefits or benefit accrual rates of individual employees. All of the safe harbors require that the plan have a uniform benefit formula, that any subsidized early retirement or joint and survivor benefits be provided on similar terms to substantially all covered employees, that the formula base benefits on a nondiscriminatory definition of compensation, and that the plan have a uniform retirement age for all employees.

The first safe harbor enables unit credit plans to satisfy section 401(a)(4) with respect to the amount of benefits on the basis of plan design. A unit credit plan is a plan that contains a formula under which all employees accrue a fixed benefit (either as a percentage of compensation or as a dollar amount) for each year of service, and all employees with the same number of years of service accrue the same benefit. For example, a plan constitutes a unit credit plan for this purpose if it provides a benefit of 1 percent of final average compensation times years of service up to 20, and 1.25 percent of final average compensation times years of service in excess of 20 but not in excess of 30.

In addition, a plan under which benefits are calculated under a unit credit formula but accrue under the fractional accrual rule may also satisfy the unit credit safe harbor, even though all employees with the same number of years of service may not accrue the same benefit. Such a plan satisfies the safe harbor only if the benefit (expressed as a percentage of compensation or a dollar amount) that any employee may accrue in any year does not exceed 133 1/3 percent of the benefit that any other employee can accrue (disregarding employees with more than 40 years of projected service under the plan).

The second safe harbor is a design-based safe harbor for flat benefit plans that satisfy the fractional accrual rule of §411(b)(1)(C) (e.g., a plan that provides a benefit of 50 percent of compensation, accrued ratably over all years of service or participation). Such a plan satisfies the safe harbor only if the plan provides that the maximum flat benefit will be accrued over a period of at least 25 years. The 25-year rule reduces the potential differences in the rates at which benefits accrue between those employees who enter the plan at younger ages and those who enter at older ages. In this way, this safe harbor applies nondiscrimination rules to flat benefit plans in a manner that takes into account the rate of benefit accrual.

The 25-year rule does not mean, however, that an employee must participate in a plan for 25 years to

accrue the full benefit permitted under section 415. Rather, the full section 415 benefit can be accrued in less than 25 years if the plan formula would produce a maximum calculated benefit in 25 years that is higher than the maximum benefit permitted by section 415. Of course, the plan must still limit actual benefits to the amount payable under section 415. For example, assume an employee is 55, earns $200,000, and the maximum benefit permitted under section 415 is $100,000 (50 percent of the employee's compensation). To satisfy the safe harbor while permitting this employee to accrue the maximum section 415 benefit in 10 years, the employer could establish a plan that provides a benefit of 125 percent of compensation at normal retirement age, accrued ratably over all years of participation (thereby satisfying the fractional accrual rule). The benefit would be proportionately reduced for years of participation less than 25, and the accrued benefit at any time would be limited by section 415. (Rev. Rul. 72-3, 1972-1 C.B. 105, which held that a pension plan could not provide benefits in excess of current compensation, was rendered obsolete by the enactment of section 415.) Under this plan, at age 65 the employee would have 10 years of participation and would therefore accrue a benefit of 10/25 of 125 percent of compensation, or 50 percent of compensation.

The third safe harbor, also for flat benefit plans, requires that the average accrual rate of nonhighly compensated employees as a group be at least 70 percent of the average accrual rate of highly compensated employees as a group. This safe harbor is applied by taking into account all employees of the employer whether they are covered under the plan or not. Although this safe harbor is not design-based, it uses data that is already maintained by the plan for purposes of determining accrued benefits and therefore imposes no additional data-gathering burden.

Since the proposed regulations are effective prospectively, all three safe harbors are available to plans under which benefits have accrued in the past under formulas that would not satisfy the safe harbors. A plan can satisfy the safe harbor even though these previously accrued benefits are preserved, provided that future benefits accrue under a formula that satisfies the safe harbors.

Those plans that do not satisfy any of the three safe harbors must satisfy the general test for nondiscrimination with respect to the amount of benefits. Under this test, a plan satisfies section 401(a)(4) with respect to the amount of benefits only if no highly compensated employee has an accrual rate greater than that of any nonhighly compensated employee. For this purpose, the disparity permitted under section 401(l) may be taken into account.

This general test requires the determination and comparison of benefit accrual rates of employees in the plan. The proposed regulations provide three methods for determining accrual rates: an annual method, an accrued-to-date method, and a projected method. Under the annual method, an employee's accrual rate is determined by subtracting the employee's accrued benefit as of the close of the prior year (expressed as a percentage of compensation) from the employee's accrued benefit as of the close of the current year. Under the accrued-to-date method, an employee's accrual rate is equal to the employee's accrued benefit to date (expressed as a percentage of compensation) divided by the employee's years of credited service to date. Under the projected method, an employee's accrual rate is equal to the employee's projected accrued benefit at normal retirement age. The projected method may not be used if the pattern of accruals under the plan discriminates in favor of highly compensated employees. A pattern of accruals discriminates if highly compensated employees accrue benefits in a more frontloaded manner than nonhighly compensated employees.

As an alternative, the accrual rate for employees under the annual, accrued-to-date, or projected methods may be determined by expressing an employee's relevant benefits as a dollar amount instead of as a percentage of compensation.

All three methods provide the option to calculate accrual rates as percentages of multi-year average compensation as determined under the plan formula. If this option is used, the formula must take into account compensation for at least 3 years, the compensation must satisfy section 414(s), and the same formula must be applied to all employees in the plan being tested. Comparing accrued benefits in this way generally eliminates differences in accrual rates that could arise merely because of differences among employees in compensation increases or length of prior service. The proposed regulations thus adopt a measure of accrual rates that simplifies their calculation and results in more uniform accrual rates among employees. To illustrate, assume a plan that provides a benefit of 1 percent of final average compensation times years of service. Under the annual method, if accrual rates are determined under the compensation formula option all employees will have an accrual rate of 1 percent (expressed as a percentage of final average compensation) under this plan. In contrast, if the annual accrual method measured the actual increase in the accrued benefit, and divided by the current year's compensation, the employees under a 1 percent final average compensation plan could have substantially varying accrual rates, depending on differences in actual compensation increases and in years of credited service.

Under any of the three methods, the employer is generally required to determine accrual rates with respect to both the normal form of benefit, i.e., a single life annuity payable at normal retirement age (this accrual rate is the normal accrual rate), and the most valuable form of benefit (this accrual rate is the most valuable accrual rate). The proposed regulations require that both the normal and the most valuable accrual rates be nondiscriminatory. Separate testing of the normal rates is not necessary, however, where early retirement subsidies and joint and survivor subsidies are provided on a substantially uniform basis. In this case, only the most valuable accrual rate must be tested.

Separate testing of normal and most valuable accrual rates generally applies where important benefit subsidies are not provided on a uniform basis. The separate testing is designed to prevent an employer from providing greater normal retirement benefits to highly compensated employees and justifying those benefits on the basis

of potentially comparable subsidies to nonhighly compensated employees. Consideration was given to permitting nondiscrimination testing on the basis of most valuable benefits alone. This approach would have required refining the valuation of contingent subsidies to take into account the probability that such benefits, which are not subject to vesting rules, would actually be paid. This approach was rejected as administratively impractical because it would require complex determinations, including determinations of the probability that contingent benefits would be paid.

The determination of the most valuable form of benefit generally follows the existing guidance in Rev. Rul. 81-202. The process of normalizing benefits, however, has been simplified by generally eliminating adjustments for ancillary benefits. An exception is provided under which a plan that provides nonhighly compensated employees with an unreduced benefit upon disability may provide higher normal retirement benefits to highly compensated employees to whom this disability benefit is not available. Generally, whether ancillary benefits are nondiscriminatory is determined on the basis of the availability of those benefits under §1.401(a)(4)-4 of the proposed regulation.

2. *Nondiscriminatory Availability of Benefits, Rights, and Features*

The second requirement a plan must satisfy under the proposed regulations is that the benefits, rights, and features provided under the plan must be made available to the employees in the plan in a nondiscriminatory manner. Rules for satisfying this requirement are set forth in §1.401(a)(4)-4 of the proposed regulations. This aspect of the proposed regulations explicitly builds on the approach now taken into the final regulations under §1.401(a)-4 with respect to optional forms of benefits and extends the substantive requirements of that section to other plan benefits, rights, and features. For example, ancillary benefits provided under a plan, such as preretirement death benefits, the right to social security supplements, or the right to purchase ancillary life insurance, must be available to a nondiscriminatory group of employees. The same standard is applied to the availability of other rights and features under the plan, such as plan loans, directed investment of account balances, and the ability to invest in employer securities. These changes reflect the direction contained in the legislative history of TRA '86 that Rev. Rul. 81-202 be modified to take into account plan options, such as loans, that are available to highly compensated employees.

The existing final regulations under §1.401(a)-4 indicate that the actuarial assumptions and methods of benefit calculation affecting the value of optional forms of benefit under a plan must be made available in a nondiscriminatory manner to the employees in the plan. The proposed regulations implement this requirement by requiring that each optional form of benefit with a different value must separately satisfy section 401(a)(4) with respect to its availability. An optional form of benefit may have different values either because the optional form itself is not offered on a uniform basis to employees (for example, a different fixed interest rate is used for computing single sum distributions), or because the same optional form is offered with respect to several different underlying benefit formulas. However, if the different benefit formulas underlying a particular optional form together satisfy the nondiscriminatory amount requirement of §1.401(a)(4)-1(b)(2), then the optional form will be treated as a single optional form of benefit.

At the same time, the proposed regulations simplify the final regulations under §1.401(a)-4 by changing the test for determining whether an optional form of benefit is available to a nondiscriminatory group of employees. Under the existing final regulations, each optional form of benefit must be available to a group of employees that satisfies either the ratio percentage test of section 410(b)(1)(B) or the nondiscriminatory classification test of section 410(b)(2)-(A)(i). If the optional form of benefit is only available to a nondiscriminatory classification of employees, the final regulations also require that the average benefit percentage test of section 410(b)(2)(A)(ii) must be satisfied. The proposed regulations eliminate the requirement that the average benefit percentage test must be satisfied in these cases. Thus, in accordance with the objective tests for coverage set forth in the proposed regulations under section 410(b), if the percentage of nonhighly compensated employees to whom an optional form of benefit is available is at least 50 percent of the percentage of highly compensated employees to whom the form is available, the optional form of benefit will satisfy the nondiscriminatory availability requirement. If the employer's work force consists primarily of nonhighly compensated employees, the relative percentage of nonhighly compensated employees to whom the form is available may be even lower.

3. *Nondiscriminatory Effect of Plan in Special Circumstances*

The third requirement a plan must satisfy under the proposed regulations is that the effect of the plan in certain special circumstances must be nondiscriminatory. Rules for satisfying this requirement are set forth in §1.401(a)(4)-5 of the proposed regulations. Under this requirement, plan amendments and grants of past service credit must not have the effect of discriminating in favor of highly compensated employees. As under existing practice, whether a plan meets this requirement depends on the relevant facts and circumstances. The use of a general anti-abuse standard based on facts and circumstances is designed to permit plans to be amended and past service credit to be granted in a manner consistent with both the nondiscrimination rules and business practices.

The proposed regulations contain a safe harbor under which a grant of up to 5 years of past service credit is deemed to be nondiscriminatory. The existence of this safe harbor does not mean that a grant of past service credit for a longer period violates the nondiscrimination rules.

The requirement that a plan's effect in certain special circumstances must be nondiscriminatory also covers plan terminations. The proposed regulations significantly liberalize existing rules that restrict distributions to highly compensated employees upon termination of a defined benefit plan. Under the proposed regulations, these restrictions are inapplicable if the payment is less than 1 percent of plan assets or, after the payment of the benefit, the value of plan assets is

at least 110 percent of the plan's current liabilities, as defined in section 412(l)(7).

4. *Employee Contributions*

Section 1.401(a)(4)-6 provides rules for defined benefit plans that include employee contributions. Generally, under the regulation, benefits derived from employer contributions and benefits derived from employee contributions must separately satisfy section 401(a)(4). In this respect, the proposed regulations further develop the existing separate treatment of employer-derived and employee-derived benefits for nondiscrimination purposes. For example, Rev. Rul. 81-202 requires separate testing of employer-derived benefits by plans being tested for comparability of contributions or benefits. Similarly, the social security integration rules of Rev. Rul. 71-446 and the permitted disparity rules of section 401(l) limit integration of benefits to employer-provided benefits. In addition, the average benefit percentage test of section 410(b) includes only employer-provided benefits.

Section 1.401(a)(4)-6 provides rules relating to the determination of the employer-derived benefit in a defined benefit plan that also includes employee contributions not allocated to separate accounts. This section also provides rules for determining whether employee contributions under a defined benefit plan are nondiscriminatory.

The determination of the employer-derived benefit generally follows the method prescribed in section 411(c), but the proposed regulations add two simpler alternatives. First, plans that meet the conditions to use uniform factors in determining employer-derived benefits for section 401(l) may also use these factors for section 401(a)(4).

Second, plans that provide a specified minimum employer-derived benefit may use uniform factors to determine the employer-derived benefit. For example, if a final average compensation plan requires an employee contribution of 1 percent of compensation, a benefit equal to 0.4 percent of final average compensation is considered attributable to employee contributions. The remaining benefit of 0.6 percent of final average compensation is treated as the employer-derived benefit. Under this second method, the plan must provide that the employee's accrued benefit will be the greater of either the employee's benefit under the plan formula or the employee's benefit derived from the employee's contributions (determined under section 411(c)) plus one-half of the employee's benefit under the formula. Thus, for example, if an employee is in a plan that provides a benefit equal to 1 percent of final average compensation times years of service, and requires a 1 percent mandatory employee contribution, the employee must receive the greater of (i) 1 percent of final average compensation times years of service, or (ii) 1/2 percent of final average compensation times years of service, plus the employee-derived benefit (determined under section 411(c)).

In addition, to simplify plan administration, plans under which mandatory employee contributions cease by the end of the 1990 plan year may treat all benefits as derived from employer contributions. Furthermore, state and local government plans may treat all benefits as employer-derived regardless of whether they satisfy any of the preceding rules.

Benefits derived from employee contributions not allocated to separate accounts (i.e., mandatory employee contributions) are treated as satisfying section 401(a)(4) if all employees in the plan contribute the same percentage of compensation.

Two special rules are provided for plans with "integrated" employee contributions, i.e., plans with higher required employee contributions with respect to higher levels of compensation. Under the first rule, the plan will satisfy section 401(a)(4) with respect to the amount of benefits derived from employee contributions not allocated to separate accounts if the total benefits under the plan would satisfy section 401(a)(4) if they were treated as completely employer-derived benefits, and if the employee contributions are made at a higher rate with respect to compensation above a specified level. For example, a plan satisfies the requirements of this rule if it provides a benefit of 1 percent of final average compensation times years of service and it requires a 1 percent employee contribution with respect to compensation above $15,000. Thus, the fact that the employee contributions are available at a greater rate with respect to higher rates of compensation is not discriminatory as long as the total benefits under the plan would be nondiscriminatory if they were treated as entirely employer-derived. Of course, the employer-derived benefits must still satisfy section 401(a)(4) separately.

The second rule for integrated employee contributions is available only to the extent a plan provides for integrated employee contributions on May 14, 1990. Under the special rules for plans with employee contributions on May 14, 1990, these plans will not fail to be nondiscriminatory if, beginning after the 1990 plan year, they make the right to make an employee contribution with respect to compensation below the specified level available to all employees, and provide that the contribution will result in a comparable additional benefit sufficient to make the total benefits under the plan nondiscriminatory when treated as entirely employer-derived.

Benefits derived from employee contributions that are allocated to separate accounts satisfy the nondiscriminatory amount requirement of section 401(a)(4) only if the employee contributions meet the specified requirements of section 401(m) set forth in §1.401(a)(4)-2(d).

5. *Permitted Disparity*

The proposed regulations allow the disparity permitted by section 401(l) to be taken into account in showing that the amount of contributions or benefits satisfies section 401(a)(4). In many cases, this merely requires inspection of the plan benefit or contribution formula, as where a plan is using one of the safe harbor rules for showing nondiscrimination in the amount of contributions or benefits. These safe harbors require that the plan formula satisfy 401(l) in form. Thus, for example, a single defined contribution plan that takes permitted disparity into account under a uniform formula satisfies section 401(a)(4) with respect to the amount of contributions if the disparity under the formula satisfies section 401(l) and the regulations thereunder. Similarly, a single defined benefit plan or target benefit plan that takes permitted disparity into account under a uniform formula satisfies section

401(a)(4) with respect to the amount of benefits if the disparity under the formula satisfies section 401(l) and the regulations thereunder.

If a plan does not use the safe harbor rules, or if two or more plans are combined for purposes of section 401(a)(4), permitted disparity is taken into account by using specified formulas that determine an adjusted allocation or accrual rate that reflects the amount of permitted disparity that may be taken into account. The adjusted rates effectively transform the allocations or accruals under the plan for each employee to determine the excess rate each employee would receive if the same dollar value of allocation or accrual had been received under a plan formula containing the maximum permitted disparity under section 401(l). The resulting excess rates are the allocation rates or accrual rates that are compared to determine whether the plan satisfies the general tests in §§1.401(a)(4)-2 or 1.401(a)(4)-3.

In developing the formulas to impute permitted disparity, consideration was given to whether the formulas should determine base rates or excess rates. Although use of either rate would generally not affect whether a plan satisfies section 401(a)(4), the formulas required to produce the excess rate are slightly more complex than those required to produce the base rate. The excess rate was nonetheless chosen because that rate ensures that the full disparity permitted is taken into account in the average benefit percentage test of section 410(b), thus causing that test to operate more accurately. For example, assume that all highly compensated employees benefit under a formula that would produce an excess rate of 2 percent and a base rate of 1.25 percent. If the excess rate is used for the average benefit percentage test, that test would be satisfied if the average excess rate for nonhighly compensated employees as a group were 1.4 percent (70 percent times 2 percent), which would in turn require that the base rate for the nonhighly compensated employees as a group be 0.7 percent to reflect the full permitted disparity. In contrast, if the base rate is used as the adjusted rate in testing, the rate for highly compensated employees in this example would be 1.25 percent, and the required base rate for nonhighly compensated employees would be 0.875 percent (70 percent times 1.25 percent), which would support an excess rate of 1.625 percent for the nonhighly compensated employees. Thus, use of the base rate would effectively not take into account the full permitted disparity.

In the development of the proposed regulations, consideration was given to whether a safe harbor method should be provided under section 401(a)(4) for plans that offset plan benefits by a portion of the primary insurance amount (PIA) under social security. A substantial number of comments were received requesting this safe harbor. Such an arrangement would not satisfy section 401(l) in form because the PIA offset may be a larger percentage of the total permitted disparity for some nonhighly compensated employee than for highly compensated employees, and the offset would therefore violate the uniformity requirements of section 401(l) and the regulations thereunder. In addition, creation of a special safe harbor rule for PIA offsets would result in complexity due to the existence of an additional set of rules relating to PIA offsets. For these reasons, a PIA offset safe harbor under section 401(a)(4) was rejected.

A PIA offset plan is, of course, permitted to use the otherwise applicable rules to satisfy section 401(a)(4). In addition, a plan may both provide for an offset that complies with the new rules and provide that the nonhighly compensated employees are offset by the lesser of that offset and an offset based on PIA. Such a plan could satisfy section 401(a)(4) by design because the nonhighly compensated employees (but not the highly compensated employees) are receiving the greater of the benefits produced under two formulas (or being offset by the smaller of two offsets), and one of the formulas satisfies section 401(l) in form.

6. *Cross-Testing Defined Benefit and Defined Contribution Plans*

The proposed regulations continue to allow a defined contribution plan (other than an ESOP or a plan subject to section 401(k) or (m)) to satisfy section 401(a)(4) based on the amount of benefits that could be purchased with the allocations made to employees' accounts under the plan. Similarly, the proposed regulations continue to allow a defined benefit plan to satisfy section 401(a)(4) based on the amount of contributions that would be necessary to fund employees' accrued benefits under the plan. Section 1.401(a)(4)-8 of the proposed regulations therefore contains methods for converting contributions to equivalent benefits and benefits to equivalent contributions, as well as rules for testing plans for nondiscrimination with respect to the amount of the resulting equivalent benefits or contributions.

Although the conversion methods contained in the proposed regulations are generally similar to the methods provided in Rev. Rul. 81-202, they differ in several significant respects. For example, the projected method in Rev. Rul. 81-202 has been eliminated. Instead, the proposed regulations generally require benefits to be converted to equivalent contributions using a method based on actual benefit accruals in the plan year being tested. Similarly, the proposed regulations require contributions to be converted to equivalent benefits using either an annual method or a method based on employees' account balances, adjusted to include certain distributions, as of the end of the plan year. These changes respond to the Congressional directive that Rev. Rul. 81-202 be modified to take into account the rate of benefit accrual. The proposed regulations also modify Rev. Rul. 81-202 by updating the interest rates that may be used in converting contributions and benefits, and by adding mortality tables permitted to be used in developing annuity factors.

The proposed regulations provide that plans that are tested with respect to an equivalent amount of contributions or benefits must satisfy the general tests for nondiscrimination with respect to the amount of contributions or benefits under section 401(a)(4) and may not use any of the design-based safe harbors provided in the regulations. Thus, for example, a defined benefit plan must generally be tested with respect to both equivalent normal and most valuable allocations. An exception is provided, however, for target benefit plans. These plans are allowed to rely on the design-based safe harbors for defined benefit plans, based on their targeted benefit formulas, provided that they deter-

mine contributions using an interest rate between 7.5 and 8.5 percent and satisfy certain other requirements. This safe harbor and the other rules in the proposed regulations relating to target benefit plans are proposed to replace the rules in Rev. Rul. 76-464, 1976-2 C.B. 115.

Section 1.401(a)(4)-8 also contains a special safe harbor testing method for defined benefit plans that are part of a floor-offset arrangement, under which benefits are reduced or "offset" by reference to an employee's account balance under a defined contribution plan maintained by the same employer. In general, the offset may be ignored in testing the defined benefit plan on a benefits basis if it is part of a floor-offset arrangement that satisfies the requirements of the safe harbor.

7. *Definition of a Plan and Plan Aggregation*

Sections 401(a)(4) and 410(b) provide a coordinated set of nondiscrimination rules for qualified plans. Therefore, §1.401(a)(4)-9 of the proposed regulations provides that the requirements of section 401(a)(4) are generally applied to the plan, portion of a plan, or aggregated plan used by the employer to satisfy section 410(b). Thus, for example, a single plan that is treated as two plans under section 414(l) is generally treated as consisting of two plans for purposes of section 401(a)(4). Similarly, a portion of a plan that is an ESOP or is subject to section 401(k) or (m), and the portion of the plan that is not, must separately satisfy section 401(a)(4).

Two plans or portions of plans that have been aggregated under section 410(b) (other than for purposes of applying the average benefit percentage test of section 410(b)(2)(B)(ii)) are also generally treated as a single plan for purposes of section 401(a)(4). This is generally the only method available for aggregating plans for purposes of section 401(a)(4). Special rules may apply, however, with respect to plans providing elective, matching, or employee contributions subject to section 401(k) or (m). Since section 410(b) generally allows two or more plans that are not mandatorily disaggregated to be treated as a single plan, even if they could have satisfied section 410(b) on their own, it is unnecessary to permit plans to be aggregated solely for purposes of section 401(a)(4).

Section 1.401(a)(4)-9 provides that plans that are aggregated under section 410(b) are generally tested for nondiscrimination under section 401(a)(4) using the rules that apply to a single plan (including the cross-testing rules described above) with several significant exceptions. First, in testing an aggregated plan that includes both defined benefit and defined contribution plans, the method for determining benefit accrual rates under the defined benefit plan is modified to make it consistent with the method in the proposed regulations for determining equivalent benefit accrual rates under the defined contribution plan.

Second, in determining whether an aggregated plan that includes both defined benefit and defined contribution plans satisfies the requirements of section 401(a)(4) with respect to the availability of benefits, rights, and features, only a limited group of "core" benefits, rights, and features—single-sum distributions, loans, ancillary benefits, and dates of benefit commencement—are required to satisfy the general availability test applicable to single plans. Non-core benefits, rights, and features made available to any highly compensated employee satisfy the availability requirements of section 401(a)(4) if they either satisfy the general test or are made available to all nonhighly compensated employees under all plans of the same type (i.e., defined contribution or defined benefit) included in the aggregated plan being tested. This rule is designed to avoid requiring an employer to offer benefits, rights, or features typical of one type of plan, but difficult to provide under the other type of plan, in order to satisfy section 401(a)(4).

8. *Plan Restructuring.*

Section 1.401(a)(4)-9 of the proposed regulations also significantly liberalizes prior practice by allowing a plan or aggregated plan to be restructured into component plans in order to pass section 401(a)(4). Under this rule, if each of the component plans of a plan or aggregated plan separately satisfies sections 401(a)(4) and 410(b) as if it were a separate plan, then the plan or aggregated plan itself satisfies section 401(a)(4). The general purpose of this rule is to permit a plan to satisfy section 401(a)(4) if it would have satisfied section 401(a)(4) had separate plans been used. No plan amendment, formal election, or other action by the employer is required to take advantage of this rule.

Section 1.401(a)(4)-9 of the proposed regulations provides three alternative methods for restructuring a plan. First, a plan is permitted to be restructured into component plans benefiting non-overlapping groups of employees. Second, a plan may be restructured into component plans consisting of different benefit or allocation rates, or groups of benefit or allocation rates, that benefit non-overlapping groups of employees. Finally, a plan may be restructured into component plans consisting of different segments of the benefit or allocation rates of an overlapping group of employees. These are the exclusive methods for restructuring a plan under section 401(a)(4).

Section 1.401(a)(4)-9 provides that the rules used to determine whether a component plan satisfies the requirements of sections 401(a)(4) and 410(b) are generally the same as those applicable to a single plan or aggregated plan. Component plans, however, are not allowed to be aggregated to pass section 410(b). Nevertheless, an aggregated plan may be restructured into component plans containing portions of two or more single plans. A further difference is that the reasonableness prong of the nondiscriminatory classification test under section 410(b) does not apply if a plan is restructured on the basis of different rates or rate segments.

9. *Testing of Former Employees*

Sections 1.401(a)(4)-1 and 1.401(a)(4)-10 of the proposed regulations require that a plan separately satisfy section 401(a)(4) with respect to the amount of benefits or contributions and the availability of benefits, rights, and features provided to current and former employees. Certain plans benefiting a significant number of former employees are deemed to satisfy both requirements. In addition, a plan under which no former employee is currently benefiting is deemed to satisfy section 401(a)(4) with respect to the amount of contri-

butions or benefits provided to former employees.

Section 1.401(a)(4)-10 provides that the rules used in determining whether a plan satisfies section 401(a)(4) with respect to the amount of contributions or benefits provided to former employees are generally the same as those used with respect to current employees. A special rule is provided for plans that are amended to provide an ad hoc cost of living adjustment.

The rules used in determining whether a plan satisfies section 401(a)(4) with respect to the availability of benefits, rights and features provided to former employees are also generally the same as those applicable to current employees. However, a plan is generally deemed to satisfy section 401(a)(4) with respect to the availability of benefits, rights, and features provided to former employees if the availability of any benefits, rights, or features subject to availability testing has not been amended since all former employees terminated employment, or, alternatively, if all amendments since that time apply uniformly to current and former employees.

In order to simplify compliance with section 401(a)(4), the proposed regulations contain a special rule in the case of plans with a loan feature. Under section 4975(d)(1) of the Code and section 408(b)(1) of the Employee Retirement Income Security Act of 1974 (ERISA), plan loans must be available on a reasonably equivalent basis to disqualified persons as defined in section 4975(e)(2) of the Code, and parties in interest, as defined in section 3(14) of ERISA, who are participants or beneficiaries of the plan. (The Secretary of Labor has authority under section 102 of Reorganization Plan No. 4 of 1978 to interpret section 4975 and ERISA section 408.) Because former employees who are disqualified persons or parties in interest are typically highly compensated former employees, the special rule provides that employers may test former employees who are parties in interest together with active employees in this limited circumstance. Compliance with section 401(a)(4) does not ensure compliance with the standards for statutory exemptions from the prohibited transaction rules for plan loans under Code section 4975(d)(1) or ERISA section 408(b)(1), or compliance with the provisions of Code section 401(a)(13).

10. *Additional Rules*

The proposed regulations contain certain additional rules necessary to implement the purposes of section 401(a)(4). These rules have been placed together in §1.401(a)(4)-11 of the proposed regulations.

Section 1.401(a)(4)-11 provides that benefits and account balances attributable to rollovers and elective transfers generally are not taken into account in determining whether the amount of benefits or contributions provided under the plan satisfies section 401(a)(4).

Section 1.401(a)(4)-11 also continues the current requirement that the manner in which employees vest in their accrued benefits under a plan must not discriminate in favor of highly compensated employees. Thus, under the proposed regulations, a plan generally does not satisfy section 401(a)(4) if benefits for highly compensated employees vest immediately, while those for nonhighly compensated employees vest after 5 years. For this purpose, the proposed regulations provide a special rule applicable to plans with different vesting schedules that are aggregated for purposes of sections 410(b) and 401(a)(4). Under this special rule, the 5-year cliff and 3-to-7 year graded vesting schedules applicable to non-top-heavy plans are deemed to provide equivalent rates of vesting; the same rule applies to the 3-year cliff and 2-to-6 year graded vesting schedules applicable to top-heavy plans. In addition, the proposed regulations provide that the determination of whether the manner in which employees vest in their accrued benefits discriminates in favor of highly compensated employees is made after taking into account any relevant provisions of sections 401(a)(5)(E), 411(d)(1) and (2), and 411(e). Existing administrative interpretations of these statutory provisions continue to apply, including, in particular, Rev. Rul. 74-166, 1974-1 C.B. 97, and Rev. Proc. 89-29, 1989-1 C.B. 893. The Internal Revenue Service solicits comments on updating the approach taken in Rev. Rul. 74-166, which provides a method for adjusting for differences in vesting schedules when two or more defined benefit plans are aggregated for purposes of sections 410(b) and 401(a)(4).

11. *Effective Dates*

The regulations are proposed to be effective for plan years beginning on or after January 1, 1991. For plan years in which the amendments made by section 1112(a) of TRA '86 apply to a plan, but before the proposed effective date, §1.401(a)(4)-13 of the proposed regulations provides that a plan must be operated in accordance with a reasonable, good faith interpretation of the requirements of section 401(a)(4). Whether compliance is reasonable and in good faith will generally be determined on the basis of facts and circumstances, including the extent to which the employer has consistently resolved all unclear issues in its favor. Reasonable, good faith compliance will be deemed to exist, however, if a plan is operated in accordance with these proposed regulations.

A special effective date is provided for plans maintained by employers described in section 414(d). For example, the rules in the proposed regulations do not apply to state and local government plans until the first plan year beginning after December 31, 1992.

In Rev. Proc. 89-65, 1989-2 C.B. 786, the Internal Revenue Service previously extended the date by which the plan amendments to comply with TRA '86 must be made until the close of the 1991 plan year. This extended amendment date, combined with the reasonable and good faith compliance standard contained in these proposed regulations, is designed to ensure that plan sponsors have a reasonable period in which to amend qualified plans.

Average Benefit Percentage Test of Section 410(b)

In addition to proposed regulations under section 401(a)(4), this document contains proposed regulations implementing the average benefit percentage test of section 410(b). In this respect, the document supplements regulations previously proposed under section 410(b) on May 18, 1989 (54 FR 21437).

The average benefit percentage test must be satisfied by a plan using the

nondiscriminatory classification test to satisfy the minimum coverage requirements of section 410(b). In order for a plan to satisfy the average benefit percentage test, the benefits provided to nonhighly compensated employees under all plans of the employer must generally be at least 70 percent as great, on average, as the benefits provided to the employer's highly compensated employees. In applying this test, the proposed regulations under section 410(b) require collectively bargained plans and certain other types of plans to be tested separately.

Satisfaction of the average benefit percentage test requires that the employer determine an employee benefit percentage for each employee taken into account for testing purposes, and then separately average the percentages of all employees in the highly compensated and nonhighly compensated groups. The proposed regulations permit benefit percentages to be determined on either a contributions or a benefits basis, following the approach used under section 401(a)(4) to determine accrual and allocation rates under aggregated plans. Employee contributions (including employee contributions subject to section 401(m)) and benefits attributable to employee contributions are not taken into account in calculating employee benefit percentages, but, unlike the rule applicable to aggregated plans under section 401(a)(4), benefits attributable to employee contributions not allocated to separate accounts may be calculated under the safe harbor rules in §1.401(a)(4)-6(b).

The proposed regulations have been designed to simplify the calculations required to determine whether a plan satisfies the average benefit percentage test. For example, they provide that employee benefit percentages under a plan are calculated on the basis of employees' normal retirement benefits, unless subsidized early retirement benefits are provided primarily to highly compensated employees. In addition, they allow compensation to be calculated with respect to any of the plan years of the plans being taken into account for testing purposes, or the calendar year overlapped by those years, in determining an employee's benefit percentage.

As provided under section 410(b)(2)-(C)(ii), in order to eliminate the effect of short-term variations in allocation or accrual rates, benefit percentages may, but need not, be calculated on the basis of allocations and accruals over a period of one, two, or three consecutive years. The proposed regulations allow employers to change from this method to the general annual method without obtaining the consent of the Commissioner.

The proposed regulations also provide a number of optional rules for use in determining whether a plan satisfies the average benefit percentage test. One option allows an employer to test its defined benefit and defined contribution plans separately, by ignoring benefits and contributions under any plans of a different type (i.e., defined contribution or defined benefit plans, respectively). This method enables employers to avoid the need to convert contributions under a defined contribution plan into equivalent benefits and benefits under a defined benefit plan into equivalent contributions. Another optional method allows an employee's most valuable benefits to be converted into equivalent most valuable contributions using the method used by the employer to calculate current plan liabilities for purposes of section 412 and Schedule B of Form 5500. Other optional methods relate to the imputation of permitted disparity, including an option to use excess rates under certain plans rather than directly imputing disparity, and an option to assume that employees under certain plans have the same average compensation. The proposed regulations also provide optional methods relating to the determination of benefit accruals using alternative methods available under section 401(a)(4), including, among others, use of an accrued-to-date method.

The use of statistical sampling techniques, and of tables for converting benefits to contributions and contributions to benefits, may permit employers to determine more economically whether their qualified plans satisfy the average benefit percentage test. The Internal Revenue Service specifically requests comments on other techniques, including sampling techniques and tables that would simplify the calculation of average benefit percentages in a manner consistent with the purposes of section 410(b).

Employee Stock Ownership Plans

The proposed regulations do not provide comprehensive guidance on the application of the nondiscrimination rules to employee stock ownership plans (ESOPs). The Internal Revenue Service and the Department of the Treasury intend to issue guidance on this subject as part of a larger package of more general ESOP guidance.

The Internal Revenue Service and the Department of the Treasury are also actively considering whether to amend §1.410(b)-7(e)(2) of the proposed regulations to eliminate the separate testing requirement for ESOPs under the average benefit percentage test. Additional guidance on this aspect of the average benefit percentage test will be issued shortly.

Failure to comply

In general, under section 402(b)(1) of the Code, if a plan fails to satisfy the qualification requirements contained in section 401(a) of the Code, the tax-exempt status of plan earnings is revoked, employer deductions for contributions may be deferred or eliminated, and all employees must include the value of plan contributions in income in accordance with section 83. Thus, if contributions are made to the plan with respect to vested accounts or benefits, employees must include these amounts in income.

In addition to the general rule of section 402(b)(1), section 402(b)(2) contains special rules that apply if the plan fails to satisfy section 401(a)(26) or 410(b). If the plan fails to satisfy either of these sections, each highly compensated employees must include in income an amount equal to the employee's entire vested accrued benefit not yet included in income. If, however, the plan is not qualified solely because it fails to satisfy the requirements of section 401(a)(26) or 410(b), no adverse tax consequences are imposed on nonhighly compensated employees.

Under the integrated approach to sections 401(a)(4) and 410(b) underlying the proposed regulations, any failure to satisfy section 401(a)(4) can be viewed as failure to satisfy section 410(b). Consequently, failure to meet the requirements of section 401(a)(4) will cause section 402(b)(2) to apply

with respect to a plan and will therefore subject highly compensated employees to the special sanctions contained in that section. Similarly, if the plan satisfies all qualification requirements other than sections 410(b) and 401(a)(26), no adverse tax consequences will be imposed on nonhighly compensated employees.

In some cases, the use of a decentralized payroll or personnel recordkeeping system may result in incomplete data that make it impossible to confirm compliance with sections 410(b) and 401(a)(4) or in inaccurate data that indicate apparent noncompliance with those sections. In these cases, the Internal Revenue Service generally will permit an employer to use reasonable estimates in lieu of the missing or inaccurate data. This permission is subject, however, to the following conditions: (1) the incomplete or inaccurate data pertain to no more than a de minimis number of employees relative to the number of employees in the testing population; (2) if the data pertain to highly compensated employees, they do not pertain to the most highly compensated employees in the testing population, and the employer has more than a small number of highly compensated employees in its overall work force; (3) the data difficulties could not have been avoided through reasonably careful administrative procedures; (4) in the case of incomplete data, the employer has made a reasonable effort to obtain the data without success; (5) in the case of inaccurate data, the data are obviously inaccurate on their face given the characteristics of the plan and the employer's work force, and the employer has made a reasonable effort to obtain accurate data without success; and (6) the employer takes appropriate steps to correct the data difficulties in future years.

Additional Authority

The rules in the proposed regulations regarding section 401(a)(4) are intended to be the exclusive rules for determining whether the requirements of that section are met. The regulations also provide, however, that the Commissioner may, in revenue rulings, notices, and other guidance of general applicability, provide any additional rules that may be necessary or appropriate in applying the nondiscrimination requirements of section 401(a)(4).

Reliance on These Proposed Regulations

Taxpayers may rely on these regulations for guidance pending issuance of final regulations. These regulations will be generally effective for plan years beginning after 1990. If future regulations are more restrictive, such guidance will be applied without retroactive effect.

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Requests to Appear at the Public Hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably a signed original and eight copies) to the Internal Revenue Service. All comments will be available for public inspection and copying in their entirety. Because the Treasury Department expects to issue final regulations on this matter as soon as possible, a public hearing will be held at 10:00 a.m. on September 26, 1990, and continued, if necessary, on September 27 and 28, 1990, in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Ave., N.W., Washington, D.C. Comments must be received by July 13, 1990. Requests to speak (with outlines of oral comments) at the public hearing must be received by Wednesday, September 12, 1990. See notice of hearing published elsewhere in * * * [Announcement 90-78, 1990-23 I.R.B. 50.

List of Subjects

26 CFR 1.401-0 through 1.425-1

Employee benefit plans, Employee stock ownership plans, Income taxes, Individual retirement accounts, Pensions, Stock options.

Proposed Amendments to the Regulations

The notices of proposed rulemaking (to amend 26 CFR Part 1) that were published on November 15, 1988 (53 FR 45917), July 11, 1988 (53 FR 26050), and May 18, 1989 (54 FR 21437), are amended, and additional amendments of Part 1 are proposed, as follows:

INCOME TAX REGULATIONS

(26 CFR Part 1)

Paragraph 1. The authority citation for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * §1.410(b)-5 also issued under 26 U.S.C. 410(b).

Par. 2. Section 1.401(a)-4 is amended by adding a sentence at the end of A-1(a)(1) and revising A-2(a)(2)(ii) and A-2(b)(4)(i) to read as follows:

§1.401(a)-4 Optional forms of benefit.

* * * * *

A-1: (a) *In general*—(1) *Scope.* * * *

See §1.401(a)(4)-4(d) for the definition of an optional form of benefit for plan years beginning after December 31, 1990.

* * * * *

A-2: (a) *Nondiscrimination requirement* * * *

(2) *Current availability* * * *

(ii) *Plan years commencing on or after TRA '86 effective date.* Except as provided in paragraph (a)(2)(iii) of this Q&A-2, for plan years commencing on or after the effective date on which the amendments made to section 410(b) by section 1112(a) of TRA '86 first apply to a plan, the requirement of this paragraph (a)(2) is satisfied only if the group of employees to whom the optional form is currently available satisfies either the percentage test set forth in section 410(b)(1)(A), the ratio test set forth in section 410(b)(1)(B), or the nondis-

criminatory classification test set forth in section 410(b)(2)(A)(i). The employer need not satisfy the average benefit percentage test in section 410(b)(2)(A)(ii) in order for the optional form to be currently available to a nondiscriminatory group of employees.

* * * * *

(b) *Application of tests* * * *

(4) *Restructuring optional forms of benefit*—(i) *In general.* For purposes of applying paragraph (a) of this Q&A-2, the availability of two or more optional forms of benefit under a plan may be tested by restructuring the benefits into two or more restructured optional forms of benefit and testing the availability of the restructured optional forms of benefit. If two or more optional forms of benefit under a plan contain both common and distinct components, the optional forms of benefit may be restructured as a single optional form of benefit comprising the common components and one or more optional forms of benefit encompassing each distinct component. The availability of each restructured optional form of benefit must satisfy the applicable nondiscrimination requirements of paragraph (a) of this Q&A-2.

* * * * *

Par. 3. New §§1.401(a)(4)-0 through 1.401(a)(4)-13 are added at the appropriate place to read as follows:

§1.401(a)(4)-0 Table of contents.

This section contains a listing of the headings of §§1.401(a)(4)-1 through 1.401(a)(4)-13.

§1.401(a)(4)-1 Nondiscrimination requirements of section 401(a)(4)

(a) In general
(b) Requirements a plan must satisfy
  (1) In general
  (2) Nondiscrimination in amount of contributions or benefits
    (i) In general
    (ii) Defined contribution plans
    (iii) Defined benefit plans
    (iv) Permitted disparity
  (3) Nondiscriminatory availability of benefits, rights, and features
  (4) Nondiscriminatory effect of plan in special circumstances
(c) Application of requirements
  (1) In general
  (2) Interpretation
  (3) Former employees
  (4) Employee-provided contributions and benefits
  (5) Plans providing section 401(h) benefits
  (6) Collectively bargained plans
  (7) Employee stock ownership plans [Reserved]
  (8) Scope of plan subject to testing
    (i) Relationship with section 410(b)
    (ii) Plan aggregation and restructuring
      (A) Plan aggregation
      (B) Restructuring
  (9) Plan year basis of testing
  (10) Rollovers and transfers
  (11) Vesting
  (12) Allocation of earnings
  (13) Definitions
  (14) Effective dates
(d) Additional rules

§1.401(a)(4)-2 Nondiscrimination in amount of contributions

(a) Introduction
  (1) General rule
  (2) Overview
  (3) Separate testing of employer and employee contributions
(b) Safe harbors for defined contribution plans
  (1) In general
  (2) Safe harbor for defined contribution plans with a uniform allocation formula
  (3) Safe harbor for defined contribution plans with a uniform allocation formula weighted for age or service
(c) General test for nondiscrimination in amount of contributions provided
  (1) In general
  (2) Allocations taken into account
  (3) Allocations not taken into account
  (4) Coordination with permitted disparity
  (5) Grouping of allocation rates
(d) Exclusive test for section 401(k) and (m) plans
  (1) Section 401(k) plans
  (2) Section 401(m) plans
  (3) Use of qualified nonelective contributions to satisfy ADP or ACP test
  (4) Restructuring and aggregating plans subject to section 401(k) and (m)
(e) Alternative methods for satisfying this section
  (1) In general
  (2) Multiple formulas
    (i) In general
    (ii) Sole formulas
    (iii) Availability
    (iv) Separate testing
  (3) Restructuring
  (4) Aggregating plans
(f) Computation of compensation for plan year

§1.401(a)(4)-3 Nondiscrimination in amount of benefits

(a) Introduction
  (1) General rule
  (2) Overview
(b) Safe harbors for plans with uniform formulas
  (1) In general
  (2) Safe harbor for unit credit plans
    (i) General rule
    (ii) Uniform unit credit formula
    (iii) Employee contributions
    (iv) Unit credit formula using fractional rule accrual
    (v) Examples
  (3) Safe harbor for flat benefit plans
    (i) General rules
    (ii) Uniform flat benefit formula
    (iii) Certain benefit increases
    (iv) Examples
  (4) Alternative safe harbor for flat benefit plans
(c) General test for nondiscrimination in amount of benefits provided
  (1) In general
    (i) General rule
    (ii) Special rule for plans with uniform formula
  (2) Accrual rates defined
    (i) In general
    (ii) Normal accrual rate
    (iii) Most valuable accrual rate
    (iv) Actuarial assumptions
      (A) In general
      (B) Mortality tables
      (C) Interest rates
  (3) Determining accrual rates
    (i) In general
    (ii) Annual accrual method
    (iii) Accrued-to-date method
    (iv) Projected accrual rate method
      (A) In general
      (B) Assumptions
      (C) Special rule for discriminatory pattern of accruals

(v) Grouping of accrual rates
(vi) Expressing relevant benefits as dollar amount
(d) Option to include disability benefits
(1) In general
(2) Includible disability benefits
(3) Value
(e) Alternative methods for satisfying this section
(1) In general
(2) Multiple formulas
(i) In general
(ii) Sole formulas
(iii) Availability
(iv) Separate testing
(3) Restructuring plans
(4) Aggregating plans
(5) Floor-offset arrangements
(f) Special rules
(1) Unpredictable contingent event benefits
(2) Compensation formulas
(i) Special rule
(ii) Example
(3) Top-heavy plans
(4) Uniform normal retirement age
(5) Accruals after normal retirement age
(6) Computation of benefits on other than plan year basis
(7) Computation of compensation on other than plan year basis

§1.401(a)(4)-4 Nondiscriminatory availability of benefits, rights, and features

(a) Overview
(b) Current and effective availability
(c) Special rule for acquisitions, mergers, and similar transactions
(d) Optional form of benefit
(e) Ancillary benefit
(f) Other right or feature
(1) Definition
(2) Examples
(3) Employee contributions to a defined benefit plan
(g) Employees with accrued benefits who are not currently benefiting
(h) Cross-reference

§1.401(a)(4)-5 Plan amendments, grants of past service credit, and plan terminations

(a) Plan amendments
(1) In general
(2) Examples
(b) Past service credits
(1) In general
(2) Safe harbor
(3) Examples
(c) Pre-termination restrictions
(1) Required provisions in defined benefit plans
(2) Restriction of benefits
(3) Restrictions on distributions
(i) Limit on annual payments
(ii) Employees whose benefits are restricted
(iii) "Benefit" defined
(4) Operational restrictions on certain money purchase pension plans

§1.401(a)(4)-6 Defined benefit plans with employee contributions

(a) Overview
(b) Determination of employer-derived and employee-derived benefits
(1) In general
(2) Composition-of-work-force method
(3) Minimum benefit method
(i) Uniform factors
(A) Final average compensation formula
(B) Career average compensation formula
(ii) Minimum benefit
(iii) Example
(4) Government plan method
(5) Cessation of employee contributions method
(c) Employee contributions not allocated to separate accounts
(1) In general
(2) General rule
(3) Total benefits method
(4) Grandfather rule for plans in existence on May 14, 1990
(d) Employee contributions allocated to separate accounts

§1.401(a)(4)-7 Effect of section 401(l) permitted disparity

(a) Overview
(1) In general
(2) Scope
(b) Defined contribution plans
(1) In general
(2) Compensation not exceeding taxable wage base
(i) Formula
(ii) Example
(3) Compensation exceeding taxable wage base
(i) Formula
(ii) Example
(c) Defined benefit plans
(1) In general
(2) Compensation not exceeding covered compensation
(3) Compensation exceeding covered compensation
(4) Example
(5) Definitions and rules of application
(i) Permitted disparity factor
(ii) Annual method
(A) Actual accrual rates
(B) Determination of employee's accrual
(C) Adjustment to permitted disparity factor for employee with more than 35 years
(iii) Accrued-to-date method
(A) Actual accrual rates
(B) Determination of employee's accrual
(C) Determination of permitted disparity factor
(iv) Projected method
(A) Actual accrual rates
(B) Determination of employee's accrual
(C) Determination of permitted disparity factor
(v) Definitions
(d) Special rules
(1) Eligible plans
(2) Multiple integration
(3) Relationship to other adjustments
(4) Transition rules
(i) Scope
(ii) Accrued-to-date method
(A) Substitute rules
(B) Determination of employee's accrual
(C) Determination of permitted disparity factor
(iii) Projected method
(A) Substitute rules
(B) Determination of employee's accrual
(C) Determination of permitted disparity factor
(5) Compensation
(i) Application of section 401(l) definition
(ii) Application to amounts testing

§1.401(a)(4)-8 Conversion of contributions and benefits

(a) In general
(b) Nondiscriminatory benefits under a defined contribution plan
(1) In general
(2) Calculation of equivalent benefit accrual rates

(3) Option to use accrued-to-date method
(i) In general
(ii) Adjusted account balance
(4) Special rule for target benefit plans
(i) Safe harbor
(ii) Eligible target benefit plans
(iii) Post normal retirement date accruals
(A) Unit credit plans
(*1*) Plans limiting years of credited service
(*2*) Plans not limiting years of credited service
(*3*) Benefit increases
(B) Flat benefit plans
(C) Plans containing employee contributions [Reserved]
(c) Nondiscriminatory contributions under a defined benefit plan
(1) In general
(2) Calculation of equivalent normal allocation rate
(3) Calculation of equivalent most valuable allocation rate
(4) Option to take value of disability benefits into account
(d) Safe harbor for defined benefit plans that are part of a floor-offset arrangement
(1) In general
(2) Safe harbor

§1.401(a)(4)–9 Definition of a plan, plan aggregation, and restructuring

(a) In general
(b) Definition of a plan
(c) Application of section 401(a)(4) to aggregated plans
(1) In general
(2) Special rules for demonstrating nondiscrimination with respect to the amount of contributions or benefits
(i) Calculation of allocation rates
(ii) Calculation of benefit accrual rates
(A) Annual method
(*1*) Aggregated plans including defined contribution plans
(*2*) Aggregated plans including no defined contribution plans
(B) Accrued-to-date method
(C) Projected method
(iii) Defined benefit plans with uniform formulas
(iv) Options and consistency rules
(3) Special rules for demonstrating nondiscriminatory availability of benefits, rights, and features
(i) In general
(ii) Core benefits, rights, and features
(A) In general
(B) Special rule for spousal benefits
(4) Special rule relating to employee contributions
(d) Plan restructuring
(1) In general
(2) Identification of component plans
(i) Permissible bases for restructuring
(A) Employee groups
(B) Total rates
(C) Rate segments
(D) Residual parts
(ii) Consistency rules
(iii) Application of grouping rules
(iv) Application of uniformity requirement for definitions of compensation
(v) Examples
(3) Satisfaction of section 401(a)(4) by a component plan
(4) Satisfaction of section 410(b) by a component plan
(i) In general
(ii) Relationship to satisfaction of section 410(b) by plan or aggregated plan
(5) Relationship to other restructuring rules
(6) Effect of restructuring under other sections

§1.401(a)(4)–10 Testing of former employees

(a) In general
(b) Amounts of contributions or benefits
(1) Plans benefiting no former employees
(2) Plans benefiting former employees
(i) General rule
(ii) Special rule
(iii) Proportional cost-of-living increases
(c) Availability of benefits, rights, or features
(1) Plans benefiting no former employees
(2) Plans benefiting former employees
(i) General rule
(ii) Special rule
(iii) Plan loans

§1.401(a)(4)–11 Special rules

(a) In general
(b) Rollovers and transfers
(1) Rollovers and elective transfers
(2) Other transfers [Reserved]
(c) Vesting
(1) In general
(2) Deemed equivalence of statutory vesting schedules
(d) Family aggregation rules [Reserved]

§1.401(a)(4)–12 Definitions

(a) Compensation
(b) Covered by a collective bargaining agreement
(c) Currently benefiting
(d) Defined benefit plan
(e) Defined contribution plan
(f) Employee
(g) Employer
(h) ESOP
(i) Former employee
(j) Highly compensated employee
(k) Highly compensated former employee
(l) Multiemployer plan
(m) Nonhighly compensated employee
(n) Nonhighly compensated former employee
(o) Professional
(p) Qualified plan
(q) Year of service

§1.401(a)(4)–13 Effective dates

(a) In general
(b) Transitional rule for governmental plans

§1.401(a)(4)–1 Nondiscrimination requirements of section 401(a)(4).

(a) *In general.* Section 401(a)(4) provides that a plan is a qualified plan only if the contributions or the benefits provided under the plan do not discriminate in favor of highly compensated employees. Whether a plan satisfies this requirement depends on the form of the plan and on its effect in operation. In making these determinations, the intent of the employer is irrelevant. This section sets forth the exclusive rules for determining whether a plan satisfies section 401(a)(4). A plan that complies in form and operation with the rules set forth in this section therefore satisfies section 401(a)(4).

(b) *Requirements a plan must satisfy*—(1) *In general.* In order to satisfy section 401(a)(4), a plan must satisfy the requirements of paragraphs (b)(2) through (b)(4) of this section.

(2) *Nondiscrimination in amount of contributions or benefits* —(i) *In general.* Either the contributions or the benefits provided under a plan must be nondiscriminatory in amount. A plan need not show that both the contributions and the benefits provided are nondiscriminatory in amount, but only that either the contributions alone or the benefits alone are nondiscriminatory in amount. Rules for determining whether the contributions provided under a plan are nondiscriminatory in amount are set forth in §1.401(a)(4)-2. Rules for determining whether the benefits provided under a plan are nondiscriminatory in amount are set forth in §1.401(a)(4)-3.

(ii) *Defined contribution plans.* A defined contribution plan generally satisfies this paragraph (b)(2) if the contributions (including forfeitures) allocated under the plan are nondiscriminatory in amount under §1.401(a)(4)-2. Except in the case of an ESOP or a plan subject to section 401(k) or (m), a defined contribution plan also satisfies this paragraph (b)(2) if the benefits provided under the plan are nondiscriminatory in amount under §1.401(a)(4)-3. Before a defined contribution plan can be tested under §1.401(a)(4)-3 based on the amount of benefits provided, the contributions under the plan first must be converted into equivalent benefits. Rules for converting contributions into equivalent benefits and for testing the equivalent benefits under §1.401(a)(4)-3 are set forth in §1.401(a)(4)-8. Those rules include a safe harbor testing method for contributions provided under a target benefit plan.

(iii) *Defined benefit plans.* A defined benefit plan generally satisfies this paragraph (b)(2) if the benefits provided under the plan are nondiscriminatory in amount under §1.401(a)(4)-3. A defined benefit plan also satisfies this paragraph (b)(2) if the contributions provided under the plan are nondiscriminatory in amount under §1.401(a)(4)-2. Before a defined benefit plan can be tested under §1.401(a)(4)-2 based on the amount of contributions provided, the benefits under the plan first must be converted into equivalent contributions. Rules for converting benefits into equivalent contributions and for testing the equivalent contributions under §1.401(a)(4)-2 are set forth in §1.401(a)(4)-8. Those rules include a safe harbor testing method for benefits provided under a defined benefit plan that is part of a floor-offset arrangement.

(iv) *Permitted disparity.* In determining whether the contributions or benefits provided under a plan are nondiscriminatory in amount, the disparity permitted under section 401(l) may be taken into account, both by plans that satisfy section 401(l) in form and by those that do not. A plan that satisfies section 401(l) in form may be able to satisfy certain design-based safe harbors under §§1.401(a)(4)-2 and 1.401(a)(4)-3. Alternatively, a plan can impute the disparity permitted under section 401(l) on an employee-by-employee basis, even in the case of a plan that does not satisfy section 401(l) in form. Rules for taking into account the disparity permitted under section 401(l) are set forth in §§1.401(a)(4)-2, 1.401(a)(4)-3, and 1.401(a)(4)-7. In no event may these rules be used by a plan to which sections 401(a)(5)(C) and 401(l) are not available.

(3) *Nondiscriminatory availability of benefits, rights, and features.* The benefits, rights, and features provided under a plan must be made available to employees in the plan in a nondiscriminatory manner. The benefits, rights, and features subject to this requirement are all optional forms of benefit, ancillary benefits, and other rights and features available to any employee under the plan. Rules for determining whether the requirement of this paragraph (b)(3) is met are set forth in §§1.401(a)(4)-4, 1.401(a)(4)-9, and 1.401(a)-4.

(4) *Nondiscriminatory effect of plan in special circumstances.* The effect of a plan in certain special circumstances must be nondiscriminatory. Special circumstances subject to this requirement include plan amendments, grants of past service credit, and plan terminations. Rules for determining whether the requirement of this paragraph (b)(4) is met are set forth in §1.401(a)(4)-5.

(c) *Application of requirements*— (1) *In general.* The requirements of paragraph (b) of this section must be applied in accordance with the rules set forth in this paragraph (c).

(2) *Interpretation.* The provisions of this section and of §§1.401(a)(4)-2 through 1.401(a)(4)-13 are to be interpreted in a reasonable manner consistent with the purpose of preventing discrimination in favor of highly compensated employees.

(3) *Former employees.* In applying the nondiscriminatory amount and availability requirements of paragraphs (b)(2) and (3) of this section, former employees are tested separately from active employees unless otherwise provided. Rules for applying the requirements of paragraphs (b)(2) and (3) to former employees are set forth in §1.401(a)(4)-10.

(4) *Employee-provided contributions and benefits.* In applying the nondiscriminatory amount requirement of paragraph (b)(2) of this section, employee-provided contributions and benefits are tested separately from employer-provided contributions and benefits, unless otherwise provided. Rules for applying the requirements of paragraph (b)(2) to employee contributions allocated to separate accounts (whether under a defined contribution plan or in conjunction with a defined benefit plan) are set forth in §§1.401(a)(4)-2 and 1.401(m)-1. Rules for applying the requirements of paragraph (b)(2) to benefits under a defined benefit plan derived from employee contributions not allocated to separate accounts are set forth in §1.401(a)(4)-6.

(5) *Plans providing section 401(h) benefits.* In applying the requirements of paragraph (b) of this section, the portion of a plan providing benefits described in section 401(h) is tested separately from the portion of the same plan providing retirement benefits. Rules applicable to plans providing section 401(h) benefits are set forth in §1.401-14(b)(2).

(6) *Collectively bargained plans.* The requirements of paragraph (b) of this section are treated as satisfied by a plan (or the portion of a plan) that automatically satisfies section 410(b) under §1.410(b)-6(e)(1) relating to certain collectively bargained plans. See section 413(b)(2) and §1.410(b)-6(e).

(7) *Employee stock ownership plans.* [Reserved.]

(8) *Scope of plan subject to testing*—(i) *Relationship with section 410(b).* To be a qualified plan, a plan must satisfy the requirements of both sections 410(b) and 401(a)(4). Section 410(b) requires that a plan cover a

nondiscriminatory group of employees, and section 401(a)(4) requires that the contributions or benefits provided to employees covered under the plan not discriminate in favor of those employees who are highly compensated. Because the requirements of sections 401(a)(4) and 410(b) form a single, coordinated nondiscrimination rule, the same plan year, employer, and group of employees must be used to satisfy both sections, unless otherwise provided.

(ii) *Plan aggregation and restructuring*—(A) *Plan aggregation.* Sections 410(b) and 401(a)(4) generally apply on a plan-by-plan basis. Under some circumstances, two or more plans are permitted to be aggregated for purposes of satisfying section 410(b). In that case, the aggregated plans also must satisfy section 401(a)(4) as a single plan. Rules relating to aggregating plans for purposes of applying the requirements of paragraph (b) of this section are set forth in §1.401(a)(4)-9.

(B) *Restructuring.* In certain circumstances, a plan may be restructured and treated as comprising two or more plans, each of which is treated as a separate plan that must independently satisfy sections 401(a)(4) and 410(b). In effect, restructuring permits a plan that might otherwise fail to satisfy section 401(a)(4) as a single plan to demonstrate compliance with section 401(a)(4) based on the components of the plan, if those components separately satisfy section 410(b). Rules relating to restructuring plans for purposes of applying the requirements of paragraph (b) of this section are set forth in §1.401(a)(4)-9.

(9) *Plan year basis of testing.* The requirements of paragraph (b) of this section are applied on the basis of the plan year. Unless otherwise provided, the compensation, contributions, benefit accruals, and other items used to apply these requirements must be determined with respect to the plan year being tested.

(10) *Rollovers and transfers.* In applying the requirements of paragraph (b) of this section, rollover contributions described in section 402(a)(5) or 403(a)(4), elective transfers described in Q&A-3(b) of §1.411(d)-4, and transfers of assets and liabilities are treated in accordance with the rules set forth in §1.401(a)(4)-11.

(11) *Vesting.* Notwithstanding any other provision in the regulations to the contrary, a plan does not satisfy the nondiscriminatory amount requirement of paragraph (b)(2) of this section if the manner in which employees vest in their accrued benefits under the plan discriminates in favor of highly compensated employees. Rules for making this determination are set forth in §1.401(a)(4)-11.

(12) *Allocation of earnings.* Notwithstanding any other provision in the regulations to the contrary, a defined contribution plan does not satisfy the nondiscriminatory amount requirement of paragraph (b)(2) of this section if the manner in which income, expenses, gains, and losses are allocated to employee accounts under the plan discriminates in favor of highly compensated employees.

(13) *Definitions.* In applying the requirements of paragraph (b) of this section, the definitions set forth in §1.401(a)(4)-12 govern, unless otherwise provided. Thus, for example, the terms "employee" and "compensation" have the meanings assigned to them in §1.401(a)(4)-12(f) and (a), unless specifically provided otherwise.

(14) *Effective dates.* In applying the requirements of paragraph (b) of this section, the effective dates set forth in §1.401(a)(4)-13 govern unless otherwise provided.

(d) *Additional rules.* The Commissioner may, in revenue rulings, notices, and other guidance of general applicability, provide any additional rules that may be necessary or appropriate in applying the nondiscrimination requirements of section 401(a)(4).

§1.401(a)(4)-2 Nondiscrimination in amount of contributions.

(a) *Introduction*—(1) *General rule.* The amount of contributions provided under a plan does not discriminate in favor of highly compensated employees if the plan satisfies the requirements of this section. Generally, both defined contribution plans and defined benefit plans can use the rules in this section to satisfy the requirement that either the contributions or the benefits provided under a plan be nondiscriminatory in amount.

(2) *Overview.* This section sets forth rules for determining whether the contributions provided under a plan are nondiscriminatory in amount. In the case of certain defined contribution plans, the requirements of this section can be satisfied by meeting one of the safe harbor tests in paragraph (b) of this section. Plans that do not satisfy one of these safe harbors generally can comply with the requirements of this section by satisfying the general test in paragraph (c) of this section. Paragraph (d) of this section sets forth the exclusive test under which portions of plans subject to section 401(k) or (m) must satisfy the requirements of this section. Paragraph (e) of this section provides alternative methods for satisfying the requirements of this section. Section 1.401(a)(4)-8 contains additional rules that explain how a de fined benefit plan satisfies §1.401(a)-(4)-1(b)(2) and this section on the basis of equivalent contributions.

(3) *Separate testing of employer and employee contributions.* In applying the requirements of this section, employer contributions are tested separately from employee contributions, except as specifically permitted for plans subject to section 401(m). To satisfy the requirements of this section, employer contributions must meet one of the tests set forth in paragraph (b), (c), or (d) of this section. Employee contributions allocated to separate accounts must satisfy the requirements in paragraph (d)(2) of this section. Employee contributions not allocated to separate accounts cannot be tested under this section, but instead must satisfy the requirements of §1.401(a)(4)-6.

(b) *Safe harbors for defined contribution plans*—(1) *In general.* A defined contribution plan satisfies the requirements of this section if it satisfies either of the safe harbor tests in paragraph (b)(2) and (b)(3) of this section.

(2) *Safe harbor for defined contribution plans with a uniform allocation formula.* A defined contribution plan satisfies this safe harbor if the plan allocates all amounts taken into account under paragraph (c)(2) of this section for the plan year under a single uniform formula that allocates the same percentage of compensation or the same dollar amount to every employee under the plan. A formula does not fail to be uniform merely because it limits allocations in accordance with section 415. In addition, a formula does not fail to be uniform merely because it takes permitted dis-

parity into account in a manner allowed under section 401(l), if every employee under the plan has the same integration level, the same base contribution percentage, and the same excess contribution percentage. For definitions of these terms, see §1.401(l)-2(b)(5), (11), and (12).

(3) *Safe harbor for defined contribution plans with a uniform allocation formula weighted for age or service.* A defined contribution plan (other than an ESOP) satisfies this safe harbor if the plan satisfies the following requirements:

(i) The plan must allocate all amounts taken into account under paragraph (c)(2) of this section for the plan year under a single uniform formula weighted for age or service. A single uniform formula weighted for age or service is one that would allocate to each employee in the plan the same percentage of compensation or the same dollar amount, if every employee had the same age and the same number of years of service or plan participation. Thus, the dollar amount of allocations may vary solely on account of compensation, age, years of service, or years of plan participation. The factors used to produce these variations must apply uniformly to all employees in the plan and must meet the effective availability requirement of §1.401(a)(4)-4. A formula does not fail to be uniform merely because it limits allocations to employees in accordance with section 415.

(ii) The average of the allocation rates for highly compensated employees in the plan does not exceed the average of the allocation rates for nonhighly compensated employees in the plan. For this purpose, allocation rates are determined in accordance with paragraph (c) of this section, without taking into account the disparity permitted under paragraph (c)(4) of this section and §1.401(a)(4)-7.

(c) *General test for nondiscrimination in amount of contributions provided*—(1) *In general.* A plan satisfies the requirements of this section if no highly compensated employee in the plan has an allocation rate that exceeds that of any nonhighly compensated employee in the plan. The allocation rate for an employee equals the sum of the allocations to the employee's account for the plan year, expressed either as a percentage of compensation or as a dollar amount.

(2) *Allocations taken into account.* The amounts taken into account in determining allocation rates include all employer contributions and forfeitures that are treated as allocated to the account of an employee for the plan year, other than amounts listed in paragraph (c)(3) of this section. In the case of a defined contribution plan subject to section 412, the amount of employer contributions taken into account is the amount of employer contributions required to be allocated under the plan to the employee's account for the plan year, even if all or part of the required contribution is not actually made.

(3) *Allocations not taken into account.* Unless otherwise provided in this section, the following amounts are not taken into account in determining allocation rates:

(i) Earnings, expenses, gains, and losses attributable to the balance in an employee's account;

(ii) Elective contributions described in §1.401(k)-1(g)(4);

(iii) Employee contributions described in §1.401(m)-1(f)(7); and

(iv) Matching contributions described in §1.401(m)-1(f)(8), including forfeitures allocated on the basis of employee or elective contributions.

(4) *Coordination with permitted disparity.* In determining allocation rates, the disparity permitted under section 401(l) may be taken into account by a plan to which sections 401(a)(5)(C) and 401(l) are otherwise available. Section 1.401(a)(4)-7 contains rules under which an adjusted allocation rate may be calculated to take into account permitted disparity.

(5) *Grouping of allocation rates.* An employer may treat employees who have allocation rates within a range of 5 percent (not 5 percentage points) above or below a midpoint rate chosen by the employer as having the same allocation rate. Alternatively, if allocation rates are determined as a percentage of compensation, an employer may treat employees who have allocation rates within a range of one-half of a percentage point as having the same allocation rate. Under either approach, after employees are grouped into ranges, each employee within a range is treated as having an allocation rate equal to the midpoint of the range. Allocation rates may be grouped under this paragraph (c)(5) only if the allocation rates of highly and nonhighly compensated employees are dispersed throughout the range in a reasonably comparable manner and the ranges chosen by the employer do not overlap with one another.

(d) *Exclusive test for section 401(k) and (m) plans*—(1) *Section 401(k) plans.* A plan that consists of contributions under a qualified cash or deferred arrangement described in §1.401(k)-1(a)(4)(i) satisfies the requirements of this section only if the plan satisfies the requirements of paragraphs (b)(2), (b)(3), (b)(4), and (e)(7) of §1.401(k)-1. Contributions under a nonqualified cash or deferred arrangement must satisfy the nondiscriminatory amount requirement of §1.401(a)(4)-1(b)(2) as if they were employer contributions to a plan not subject to section 401(k) or (m).

(2) *Section 401(m) plans.* A plan that consists of contributions subject to section 401(m) satisfies the requirements of this section only if the plan satisfies the requirements of paragraphs (b)(1), (b)(2), (b)(3), and (e)(4)(ii) of §1.401(m)-1.

(3) *Use of qualified nonelective contributions to satisfy ADP or ACP test.* If a plan treats any qualified nonelective contributions as elective contributions for purposes of the actual deferral percentage test, §1.401(k)-1(b)(3)(i) and (ii) provides that the requirements of section 401(a)(4) must be satisfied by certain nonelective contributions under the plan. Section 1.401(m)-1(b)(2)(i) and (ii) imposes the same requirements if the plan treats any qualified nonelective contributions as matching contributions for purposes of the actual contribution percentage test. A plan satisfies the requirements of section 401(a)(4) with respect to the nonelective contributions described in §1.401(k)-1(b)(3)(i) and (ii) and in §1.401(m)-1(b)(2)(i) and (ii) only if:

(i) The portion of the plan that is not subject to section 401(k) or (m) satisfies the nondiscriminatory amount requirement of §1.401(a)(4)-1(b)(2), taking into account all nonelective contributions under the plan (as described in §§1.401(k)-1(b)(3)(i) and 1.401(m)-1(b)(2)(i)); and

(ii) The portion of the plan that is not subject to section 401(k) or (m) satisfies the nondiscriminatory

amount requirement of §1.401(a)(4)-1(b)(2), without taking into account under paragraph (c)(2) of this section qualified nonelective contributions treated either as elective contributions for purposes of the actual deferral percentage test or as matching contributions for purposes of the actual contribution percentage test.

For purposes of this paragraph (d)(3), the term "plan" means a plan as defined in §1.410(b)-7 without regard to paragraphs (c)(3) and (e) thereof.

(4) *Restructuring and aggregating plans subject to section 401(k) and (m).* A plan subject to sections 401(k) or (m) may satisfy this paragraph (d) on a restructured basis pursuant to the rules of §1.401(a)(4)-9(d). In addition, two or more plans subject to section 401(k) may be treated as a single plan pursuant to §1.401(k)-1(b)(5)(i), and two or more plans subject to section 401(m) may be treated as a single plan pursuant to §1.401(m)-1(b)(4)(i).

(e) *Alternative methods for satisfying this section*—(1) *In general.* A plan that is not subject to section 401(k) or (m) and that does not satisfy any of the tests in paragraph (b) or (c) of this section satisfies the requirements of this section if it does so using one of the alternative testing methods set forth in paragraphs (e)(2) through (4) of this section.

(2) *Multiple formulas*—(i) *In general.* A plan satisfies the requirements of this section if an employee's allocation under the plan is the greater of the allocations under two or more formulas that satisfy the requirements of paragraph (e)(2)(ii) through (iv) of this section. Alternatively, a plan satisfies the requirements of this section if an employee's allocation under the plan is the sum of the allocations under two or more formulas that satisfy the requirements of paragraph (e)(2)(ii) through (iv) of this section.

(ii) *Sole formulas.* The formulas are the only formulas under the plan.

(iii) *Availability.* Each of the formulas is available to at least all nonhighly compensated employees in the plan.

(iv) *Separate testing.* Each of the formulas separately satisfies the requirements of this section.

(3) *Restructuring.* A plan may satisfy the rules of paragraph (b) or (c) of this section on a restructured basis pursuant to the rules of §1.401(a)(4)-9.

(4) *Aggregating plans.* A plan may satisfy the rules of paragraph (b) or (c) of this section on an aggregated basis with one or more other plans pursuant to the rules of §1.401(a)(4)-9.

(f) *Computation of compensation for plan year.* For purposes of this section, compensation is determined based on the plan year. Nevertheless, an employer may, but need not, determine compensation on the basis of the calendar year ending within the plan year as long as the calendar year determination applies to all employees under the plan for the plan year.

§1.401(a)(4)-3 Nondiscrimination in amount of benefits.

(a) *Introduction*—(1) *General rule.* The amount of benefits derived from employer contributions provided under a plan does not discriminate in favor of highly compensated employees if the plan satisfies the requirements of this section. Generally, both defined benefit plans and defined contribution plans can use the rules in this section to satisfy the requirement that either the contributions or benefits provided under a plan be nondiscriminatory in amount.

(2) *Overview.* This section sets forth rules for determining whether the employer-derived benefits provided under a plan are nondiscriminatory in amount. In the case of certain defined benefit plans, the requirements of this section can be satisfied by meeting one of the safe harbor tests in paragraph (b) of this section. Two of these safe harbors are design based and do not require the determination and comparison of actual benefits under the plan. Plans that do not satisfy one of these safe harbors generally can comply with the requirements of this section only by satisfying the general test in paragraph (c) of this section. The general test may require the valuation of benefits and the determination of individual benefit accrual rates to show compliance. Paragraph (d) of this section provides an optional rule for including the value of certain disability benefits in determining accrual rates under this section. Paragraph (e) of this section explains alternative methods for satisfying the requirements of this section. Paragraph (f) of this section provides special rules to be used in applying the tests of this section. Section 1.401(a)(4)-8 contains additional rules that explain how a defined contribution plan satisfies §1.401(a)(4)-1(b)(2) and this section on the basis of equivalent benefits.

(b) *Safe harbors for plans with uniform formulas*—(1) *In general.* A defined benefit plan satisfies the requirements of this section for a plan year if the plan satisfies any of the safe harbors in this paragraph (b).

(2) *Safe harbor for unit credit plans*—(i) *General rule.* A plan satisfies this paragraph (b)(2) for a plan year if it is a plan under which employees in the plan accrue a specific benefit for each year of service (either as a percentage of compensation or as a fixed dollar amount), benefits for a plan year accrue under a unit credit formula that is uniform for all employees in the plan, and the plan satisfies the accrual requirement of section 411(b)(1)(B) (the 133⅓ percent rule).

(ii) *Uniform unit credit formula.* A unit credit formula is uniform for all employees in the plan only if it meets the following requirements:

(A) All employees in the plan are subject to the same benefit formula.

(B) The benefit formula provides that the same dollar amount or the same percentage of compensation will be accrued for the current and subsequent plan years by all employees in the plan who have the same number of years of service credited under the plan for purposes of benefit accruals. In making this determination, the effect of the limits under section 415(b) and (e) is disregarded. A benefit formula does not fail to satisfy the requirement of this paragraph (b)(2)(ii)(B) merely because the formula provides a disparity that by its terms satisfies section 401(l).

(C) If benefits are based on compensation, a compensation formula that meets the requirements of paragraph (f)(2) of this section is used.

(D) All subsidized early retirement benefits and subsidized joint and survivor annuities with respect to benefits accruing in the current and subsequent plan years are available to substantially all employees in the plan on similar terms.

(E) The plan provides a uniform retirement age for all employees in the plan.

(iii) *Employee contributions.* A plan that includes employee contributions that are not allocated to separate accounts satisfies this paragraph (b)(2) only if the plan is eligible to determine employee-derived benefits under §1.401(a)(4)–6(b)(2) or (3) (the composition of work force method and the minimum benefit method, respectively) or the plan satisfies §1.401(a)(4)–6(b)(4) or (5) (the government plan method and the cessation of employee contributions method, respectively).

(iv) *Unit credit formula using fractional rule accrual.* A unit credit plan that provides that benefits are accrued under the fractional accrual rule of section 411(b)(1)(C) satisfies the requirements of this paragraph (b)(2) only if under the formula no employee in the plan can accrue, in any one year, more than 133⅓ percent of the benefit (expressed as a percentage of compensation or a dollar amount) that any other employee in the plan will accrue, disregarding employees with projected service in excess of 40 years. Such a plan need not satisfy section 411(b)(1)(B) or paragraph (b)(2)(ii)(B) of this section. For purposes of this rule, if a plan provides a disparity that by its terms satisfies section 401(l), an employee can be treated as accruing benefits either at the excess benefit percentage rate in the case of an excess plan or at the rate prior to reduction by the offset in the case of an offset plan. Section 1.401(l)–1(b) defines "excess plan," "offset plan," and "excess benefit percentage."

(v) *Examples.* The rules of this paragraph (b)(2) are illustrated by the following examples. In each example, it is assumed that the plans satisfy paragraphs (b)(2)(ii)(A), (C), (D), and (E) of this section, that none of the plans has ever permitted employee contributions, and that none of the plans provide past service credit that fails to satisfy the requirement of §1.401(a)(4)–5.

Example 1. Plan A provides a specific annual accrual for each employee in the plan payable at normal retirement age. For the first 5 years of plan participation the annual accrual is 1.5 percent of compensation. For the next 5 years of plan participation the annual accrual is 1.75 percent, and for all additional years the annual accrual is 2 percent. Plan A satisfies this paragraph (b)(2).

Example 2. Plan B provides a specific annual accrual for each employee in the plan payable at normal retirement age. For the first 5 years of plan participation the annual accrual is 2 percent of compensation, and for later years the annual accrual is 1 percent. Plan B satisfies this paragraph (b)(2).

Example 3. Plan C provides for a benefit equal to 1.6 percent of compensation times each year of service up to 35. Plan C further provides that an employee's accrued benefit as of a given year equals the benefit projected as of normal retirement age multiplied by the ratio of the employee's years of service as of the year to the employee's projected years of services as of normal retirement age (i.e., the plan benefits accrue under the fractional rule of section 411(b)(1)(C)). The greatest benefit that an employee can earn in any one year is 1.6 percent of compensation (this is the case for any employee in the plan who will have 35 or fewer years of projected service at normal retirement age). The lowest benefit that will accrue for an employee in the plan with no more than 40 projected years of service is 1.4 percent (this is the case for any employee in the plan with 40 years of projected service under the formula). Since 1.6 percent is not more than 133⅓ percent of 1.4 percent, Plan C satisfies the rule in paragraph (b)(2)(iv) of this section.

Example 4. Plan D satisfies section 401(l) and provides for a benefit equal to 1.0 percent of compensation up to the integration level, and 1.6 percent of compensation over the integration level, times each year of service up to 35. Plan D further provides that an employee's accrued benefit as of a given year equals the benefit projected as of normal retirement age multiplied by the ratio of the employee's years of service as of the year to the employee's projected years of services as of normal retirement age (i.e., the plan benefits accrue under the fractional rule of section 411(b)(1)(C)). For purposes of satisfying the 133 1/3 percent rule in paragraph (b)(2)(iv) of this section, all employees in the plan can be assumed to accrue benefits at the excess rate of 1.6 percent. Thus, the greatest benefit that an employee can earn in any one year is 1.6 percent of pay (this is the case for any employee in the plan who will have 35 or fewer years of projected service at normal retirement age). The lowest benefit that will accrue for an employee under the plan with no more than 40 projected years of service is 1.4 percent (this is the case of an employee in the plan with 40 years of projected service under the formula). Since 1.6 percent is not more than 133 1/3 percent of 1.4 percent, Plan D satisfies the rule in paragraph (b)(2)(iv) of this section.

Example 5. Plan E provides for a benefit equal to 4 percent of compensation times each year of service up to 10 and 1 percent of compensation times each year of service in excess of 10 and not in excess of 30. Plan E further provides that an employee's accrued benefit as of a given year equals the benefit projected as of normal retirement age multiplied by the ratio of the employee's years of service as of the year to the employee's projected years of service as of normal retirement age (i.e., the plan benefits accrue under the fractional rule of section 411(b)(1)(C)). The greatest benefit that an employee can earn in any one year is 4 percent of compensation (this is the case for any employee who will have 10 or fewer years of projected service at normal retirement age). The lowest benefit that will accrue for an employee with no more than 40 projected years of service is 1.5 percent (this is the case of an employee with 40 years of projected service under the formula). Since 4 percent is more than 133 1/3 percent of 1.5 percent, Plan E fails to satisfy the rule in paragraph (b)(2)(iv) of this section.

(3) *Safe harbor for flat benefit plans*—(i) *General rules.* A plan satisfies this paragraph (b)(3) for a plan year if it provides a flat benefit at normal retirement age (e.g., 50 percent of compensation), benefits under the plan accrue under a flat benefit formula that is uniform for all employees in the plan, and the plan satisfies the fractional accrual rule of section 411(b)(1)(C).

(ii) *Uniform flat benefit formula.* A flat benefit formula is uniform for all employees in the plan only if it meets the following requirements:

(A) All employees in the plan are subject to the same benefit formula providing the same flat benefit. A benefit formula does not fail to satisfy this requirement merely because the formula provides a disparity that by its terms satisfies section 401(l). Also, a plan does not fail to satisfy this requirement solely due to benefits that were previously accrued under a uniform formula and that are protected by reason of section 411(d)(6).

(B) The maximum flat benefit in the plan for any highly compensated employee in the plan accrues over a period of at least 25 years of service or would accrue over such a period if the limits imposed by section 415(b) and (e) were disregarded. The maximum flat benefit must accrue ratably over that period. Thus, an employee may accrue the maximum benefit permitted under section 415(b) over a period of less than 25 years, provided that the maximum benefit under the plan, determined without regard to section 415, can accrue over no less than 25 years. The 25-year period may take into account years for which past serviee credit meeting the requirements of §1.401(a)(4)–5 has been granted, if no more than 4 percent of the maximum flat benefit is accrued for any of those years.

(C) If benefits are based on compensation, a compensation formula that satisfies paragraph (f)(2) of this section is used.

(D) All early retirement benefits

and subsidized joint and survivor annuities with respect to the benefits accrued for the current and subsequent plan years are available to substantially all employees in the plan on similar terms.

(E) The plan provides a uniform retirement age for all employees in the plan.

(F) The plan does not include employee contributions other than employee contributions allocated to separate accounts.

(iii) *Certain benefit increases.* A plan does not fail to satisfy the requirements of this paragraph (b)(3) merely because of increases in benefits that accrued in plan years beginning before January 1, 1991, if such increases are due solely to increases in compensation taken into account under the plan formula, increases in the maximum benefit permitted under section 415(b)(1)(A), and cost-of-living adjustments not in excess of those prescribed pursuant to section 415(d)(1)(A).

(iv) *Examples.* The rules of this paragraph (b)(3) are illustrated by the following examples. Assume for purposes of each example that the plan satisfies paragraphs (b)(3)(ii)(A), (C), (D), (E), and (F) of this section, that the plan has never permitted employee contributions, and that none of the plans provides past service credit that fails to satisfy the requirements of §1.401(a)(4)-5.

Example 1. Plan A provides each employee in the plan with a benefit of 100 percent of compensation at normal retirement age (age 65), subject to the benefit limitations of section 415(b). Plan A further provides that an employee's accrued benefit as of any year is equal to 100 percent of final compensation times the lesser of the ratio of years of service as of such year to projected service as of age 65 and 0.04 (or 4 percent) times the years of service as of such year. Thus, for example, the benefit of an employee in the plan who is age 60 and has 5 years of service would be 20 percent of final pay (100 percent times the lesser of 1/2 and 0.2). Plan A satisfies the requirements of this paragraph (b)(3).

Example 2. Employer B wants to establish a defined benefit plan when Employee X is 55. Employer B wants the plan to provide Employee X with a benefit of 50 percent of compensation at age 65 if Employee X works until age 65. Employer B establishes Plan B, which provides a benefit at normal retirement age (age 65) of 125 percent of compensation subject to the benefit limitations of section 415(b). Plan B further provides that an employee's accrued benefit as of any year is equal to 125 percent of compensation times the lesser of the ratio of years of service as of such year to projected service as of age 65 and 0.04 (or 4 percent) times the years of service as of such year. Under this formula, Employee X would receive a benefit at age 65 of 50 percent of compensation (125 percent times the lesser of 1 and 0.4). Plan B satisfies the requirements of this paragraph (b)(3), even though Employee X will accrue the maximum benefit allowed under section 415(b) in less than 25 years.

(4) *Alternative safe harbor for flat benefit plans.* A plan satisfies this paragraph (b)(4) if it would meet the safe harbor flat benefit plan test of paragraph (b)(3) of this section but for the 25-year accrual rule of paragraph (b)(3)(ii)(B) of this section, and if the average of the normal accrual rates for all nonhighly compensated employees is at least 70 percent of the average of the normal accrual rates for all highly compensated employees. To determine the average normal accrual rate for highly and nonhighly compensated employees, all highly and nonhighly compensated employees are taken into account (regardless of whether they are covered under the plan) except those employees who are excludable under section 410(b)(3) and (4). In addition, contributions and benefits under other plans of the employer are disregarded. For purposes of this paragraph (b)(4), the normal accrual rate is determined in the same manner as under paragraph (c)(3)(ii) of this section.

(c) *General test for nondiscrimination in amount of benefits provided*—(1) *In general*—(i) *General rule.* A plan satisfies the requirements of this section for a plan year only if no highly compensated employee in the plan has a normal accrual rate that exceeds the normal accrual rate for any nonhighly compensated employee in the plan, and no highly compensated employee in the plan has a most valuable accrual rate that exceeds the most valuable accrual rate for any nonhighly compensated employee in the plan. Thus, a plan must generally determine two accrual rates for each employee in the plan. These are the normal accrual rate, which is based on the single life annuity payable under the plan at normal retirement age, and the most valuable accrual rate, which is based on the most valuable annuity payable under the plan. These accrual rates are defined in paragraph (c)(2) of this section and are determined by applying one of the methods in paragraph (c)(3) of this section.

(ii) *Special rule for plans with uniform formula.* A plan with a uniform formula satisfies this section if no highly compensated employee in the plan has a most valuable accrual rate that exceeds the most valuable accrual rate of any nonhighly compensated employee in the plan. For this purpose, a benefit formula is uniform only if the normal retirement benefit for all employees in the plan is determined under the same formula and is based on a single compensation formula that satisfies paragraph (f)(2) of this section and on a uniform normal retirement age for all employees in the plan. In addition, any feature that would affect the value of the most valuable annuity under paragraph (c)(2)(iii) of this section must be available on the same terms to all employees in the plan. Solely in the case of a plan with a uniform formula, the most valuable accrual rate under paragraph (c)(2)(iii) of this section must be determined by assuming that each employee in the plan satisfies any service requirement to receive a benefit payable before normal retirement age.

(2) *Accrual rates defined*—(i) *In general.* Accrual rates are determined with respect to the employer-derived benefit only. In the case of a defined benefit plan that includes employee contributions not allocated to separate accounts, the determination of the employer-derived benefit is made pursuant to the rules of §1.401(a)-(4)-6. In determining accrual rates, a plan may take into account permitted disparity under the rules of §1.401(a)(4)-7. In calculating accrual rates under a defined benefit plan, the limits of section 415(b) and (e) are disregarded. Thus, an employee's accrual rates are determined without regard to the limits imposed by those sections. Any increase in an employee's accrued benefit due solely to an increase in these limits is disregarded in determining accrual rates.

(ii) *Normal accrual rate.* The normal accrual rate for any employee in the plan is the accrual rate, determined under one of the methods in paragraph (c)(3) of this section, with respect to the single life annuity payable to the employee commencing at normal retirement age or, if later, the employee's current age. If the normal form of benefit at normal retirement age is other than a single life annuity,

the normal form must be converted to an actuarially equivalent single life annuity. If the plan does not provide a single normal retirement age, then the single life annuities for employees who have not yet attained the latest possible uniform normal retirement age must be converted to single life annuities commencing at a uniform normal retirement age. For purposes of this paragraph (c)(2)(ii), actuarial assumptions that satisfy paragraph (c)(2)(iv) of this section must be used to determine the actuarially equivalent single life annuities.

(iii) *Most valuable accrual rate.* The most valuable accrual rate for any employee in the plan is the accrual rate, determined under one of the methods in paragraph (c)(3) of this section, with respect to the most valuable annuity payable to the employee under the plan. Q&A-16 of §1.401(a)-20 provides that the qualified joint and survivor annuity (QJSA) must be at least as valuable as any other form of optional benefit payable to a married employee in the plan. The most valuable annuity is therefore selected by first determining the QJSA payable at each age at which each employee in the plan will become eligible for early or normal retirement under the plan. To determine the value of the QJSA, the employee is assumed to have a spouse of the same age. Each QJSA is converted to a single life annuity beginning at normal retirement age or, if later, the employee's current age, using actuarial assumptions meeting the requirements of paragraph (c)(2)(iv) of this section. The most valuable annuity is the largest of the single life annuities payable at normal retirement age. If the plan does not provide a single normal retirement age, then the single life annuities for employees who have not yet attained the latest possible uniform normal retirement age must be converted to single life annuities commencing at a uniform normal retirement age.

(iv) *Actuarial assumptions*—(A) *In general.* The actuarial assumptions applied for purposes of determining actuarial equivalence under this section must be reasonable and must be applied on a consistent basis. The actuarial assumptions specified in paragraphs (c)(2)(iv)(B) and (C) of this section are considered reasonable. The Commissioner may, in revenue rulings, notices, and other guidance of general applicability, change these assumptions.

(B) *Mortality tables.* Any one of the following mortality tables is considered reasonable: the 1983 Group Annuity Mortality Table (1983 GAM); the 1983 Individual Annuity Mortality Table (1983 IAM); the UP-1984 Mortality Table; the 1971 Group Annuity Mortality Table (1971 GAM); or the 1971 Individual Annuity Mortality Table (1971 IAM).

(C) *Interest rates.* An interest rate is considered reasonable if it is not less than 7.5 percent or greater than 8.5 percent compounded annually.

(3) *Determining accrual rates*—(i) *In general.* Accrual rates must be determined under one of the three methods in this paragraph (c)(3). The same method must be used for all employees in the plan, and the same method must be used for determining the normal and most valuable accrual rates. Under each method, if benefits are expressed as a percentage of compensation, the percentage must be calculated using compensation either as defined in §1.401(a)(4)-12(a) or as determined under a uniform compensation formula satisfying paragraph (f)(2) of this section.

(ii) *Annual accrual method.* Under the annual accrual method of determining the normal and most valuable accrual rates, the accrual rate for an employee in the plan for a plan year is determined by subtracting:

(A) The employee's relevant benefit (i.e., normal retirement benefit or most valuable annuity) accrued as of the close of the prior plan year, expressed as a percentage of the employee's compensation as of the close of that prior year, from

(B) The employee's relevant benefit accrued as of the close of the plan year, expressed as a percentage of the employee's compensation as of the close of that year. In calculating the relevant accrued benefit as of the close of the plan year, amounts attributable to a past service credit described in §1.401(a)(4)-5(b)(1) are taken into account unless the past service credit satisfies the requirements of §1.401(a)(4)-5.

(iii) *Accrued-to-date method.* Under the accrued-to-date method of determining the normal and most valuable accrual rates, the accrual rate for an employee under the plan for a plan year is equal to the employee's relevant benefit accrued at the close of the plan year, expressed as a percentage of compensation as of the close of such year, divided by the employee's years of participation under the plan or, if greater, by the employee's years of service credited under the plan. This method may, but need not, be applied solely with respect to benefits accrued and participation in plan years beginning after a selected date no later than December 31, 1990.

(iv) *Projected accrual rate method*—(A) *In general.* The projected accrual rate for an employee in the plan for a plan year is determined by dividing the relevant benefits that will be accrued under the plan (both benefits accrued to date and benefits projected to be accrued in the future), expressed as a percentage of compensation, by the number of years over which those benefits will have accrued. In determining the normal accrual rate, the relevant benefits are those that have already accrued and that will be accrued from the beginning of the plan year being tested through the end of the plan year in which the employee attains the later of normal retirement age or the employee's current age. This total, expressed as a percentage of compensation, is then divided by the sum of the plan years in which the employee will have participated in the plan as of this age or, if greater, the number of plan years that will be taken into account for benefit accrual at this age. In determining the most valuable accrual rate, only those benefits and years of service that have already accrued and that will be accrued from the beginning of the plan year being tested through the year in which the employee is eligible for the most valuable annuity are taken into account. This method may, but need not, be applied solely with respect to benefits accrued and participation in plan years beginning after a selected date no later than December 31, 1990.

(B) *Assumptions.* For purposes of this paragraph (c)(3)(iv), future benefits are projected by assuming that there is no change in the employee's annual compensation and annual hours of service or in the section 401(a)(17) limit on compensation. The

employee's age and service are projected from the beginning of the current plan year to normal retirement age or to the age at which the most valuable annuity commences, as applicable.

(C) *Special rule for discriminatory pattern of accruals.* The projected accrual rate method cannot be used for a plan year if the pattern of accruals under the plan results in discrimination in favor of highly compensated employees in the plan. The pattern of accruals refers to the manner in which projected benefits actually accrue over the period of accrual (i.e., whether projected benefits accrue in a level manner or in a relatively frontloaded or backloaded manner). Whether a pattern of accruals results in discrimination in favor of highly compensated employees is determined on the basis of all relevant facts and circumstances. A pattern of accruals that results in discrimination in favor of highly compensated employees exists if the pattern of accrual of the highly compensated employees in the plan is frontloaded when compared to the pattern of accrual of the nonhighly compensated employees in the plan. The rules in this paragraph (c)(3)(iv)(C) are illustrated by the following example:

Example. Employer P maintains a plan under which headquarters employees in the plan accrue a benefit of 1.25 percent for the first 10 years of service and 0.75 percent for subsequent years of service, while all other employees in the plan accrue a benefit of 1 percent for all years of service. The group of headquarters employees in the plan does not satisfy section 410(b)(1)(B) or (2). The plan formula provides a pattern of accruals that discriminates in favor of highly compensated employees, and the plan may therefore not be tested using the projected accrual rate method.

(v) *Grouping of accrual rates.* An employer may treat employees who have accrual rates within a range of 5 percent (not 5 percentage points) above or below a midpoint rate chosen by the employer as having the same accrual rate. Alternatively, if accrual rates are determined as a percentage of compensation, an employer may treat employees who have accrual rates within a range of one-tenth of a percentage point as having the same accrual rate. Accrual rates may be grouped under this paragraph (c)(3)(v) only if the accrual rates of highly compensated employees and nonhighly compensated employees are dispersed throughout the range in a reasonably comparable manner and the ranges chosen by the employer do not overlap with one another.

(vi) *Expressing relevant benefits as dollar amount.* The accrual rate for employees may be determined under this paragraph (c)(3) by expressing the employees' relevant benefits as a dollar amount instead of as a percentage of compensation.

(d) *Option to include disability benefits*—(1) *In general.* For purposes of paragraphs (b)(4) and (c) of this section, an employer may, but need not, include the value of disability benefits described in this paragraph (d) in determining the normal and most valuable accrual rates. If disability benefits are taken into account, they must be taken into account on a uniform basis in determining both the normal and the most valuable accrual rates with respect to all employees eligible for the benefits under the plan.

(2) *Includible disability benefits.* A disability benefit may be taken into account only if it is equal to the maximum qualified disability benefit within the meaning of section 411(a)(9), the employee is treated as disabled under the plan if the employee is unable to perform his or her usual occupation and the actual experience of the employer or the nature of the work being performed by employees to whom the benefit is available indicate that it is reasonable to treat the disability benefit as a meaningful and significant benefit.

(3) *Value.* The value of the disability benefit is taken into account by multiplying both the normal and most valuable accrual rates by 1.11. The factor is applied before imputing permitted disparity under §1.401(a)(4)-7 and before grouping accrual rates under paragraph (c)(3)(v) of this section.

(e) *Alternative methods for satisfying this section*—(1) *In general.* A plan that does not satisfy any of the tests in paragraphs (b) or (c) of this section satisfies the requirements of this section if it does so using one of the alternative testing methods set forth in paragraphs (e)(2) through (5) of this section.

(2) *Multiple formulas*—(i) *In general.* A plan satisfies the requirements of this section if an employee's benefit under the plan is the greater of the benefits under two or more formulas that satisfy the requirements of paragraph (e)(2)(ii) through (iv) of this section. Alternatively, a plan satisfies the requirements of this section if an employee's benefit under the plan is the sum of the benefits under two or more formulas that satisfy the requirements of paragraph (e)(2)(ii) through (iv) of this section.

(ii) *Sole formulas.* The formulas are the only formulas under the plan.

(iii) *Availability.* Each of the formulas is available to at least all nonhighly compensated employees in the plan.

(iv) *Separate testing.* Each of the formulas separately satisfies the requirements of this section.

(3) *Restructuring plans.* A plan may satisfy this section on a restructured basis pursuant to the rules of §1.401(a)(4)-9. Thus, for example, a plan that does not have a single uniform formula described in paragraph (b) of this section may restructure benefits to create two or more uniform formulas that satisfy paragraph (b) of this section.

(4) *Aggregating plans.* A plan may satisfy this section on an aggregated basis with one or more other plans pursuant to the rules of §1.401(a)(4)-9.

(5) *Floor-offset arrangements.* For special rules relating to defined benefit plans that are part of a floor-offset arrangement, see §1.401(a)(4)-8(d).

(f) *Special rules*—(1) *Unpredictable contingent event benefits.* If a benefit is an unpredictable contingent event benefit as described in section 412(l)(5) and would otherwise be taken into account in determining whether the amount of benefits under a plan is discriminatory, the benefit is not taken into account under this section until the contingent event arises. An unpredictable contingent event benefit is, however, tested on the basis of availability under the rules of §1.401(a)(4)-4.

(2) *Compensation formulas*—(i) *Special rule.* In general, a compensation formula satisfies the requirements of this paragraph (f)(2) if:

(A) The formula bases benefits on compensation for at least 3 years or 3 12-month periods (or the employee's period of employment, if shorter);

(B) The same compensation formula is applied to determine the accrual

rate of every employee; and

(C) The compensation taken into account under the formula for each plan year was nondiscriminatory in such plan year. For plan years beginning after December 31, 1987, this requirement is met if the compensation taken into account satisfies section 414(s).

(ii) *Example.* The special rule of this paragraph (f)(2) is illustrated by the following example:

Example. Plan A is a final average pay plan that bases benefits for all employees on high 5 consecutive plan years' compensation. For the 1990 plan year, the plan defines compensation as wages subject to income tax withholding. For the 1988 and 1989 plan years, the plan defined compensation as section 415(c)(3) compensation. For plan years beginning before January 1, 1988, the plan based benefits on base pay and bonuses. That definition was nondiscriminatory based on the relevant facts for such years. Because the definition of compensation for each year is the same for all employees and is nondiscriminatory and because the compensation formula takes into account compensation for a 5-year period (or such shorter period as the employee was employed), the plan compensation formula satisfies paragraph (f)(2) of this section.

(3) *Top-heavy plans.* A top-heavy plan, as defined in section 416(g), will not fail to provide a uniform formula for purposes of this section merely because the formula provides that non-key employees will accrue a benefit at least equal to the minimum benefit required under section 416(c)(1).

(4) *Uniform normal retirement age.* A plan will not fail to have a uniform normal retirement age for purposes of this section merely because the plan defines normal retirement age as the later of a stated age or a stated anniversary date after an employee commences participation in the plan, as permitted under section 411(a)(8)(B)(ii).

(5) *Accruals after normal retirement age.* In general, accruals for any plan year after the plan year in which an employee attains normal retirement age are taken into account for purposes of this section. An employee whose accrued benefit does not increase after attaining normal retirement age, except to the extent that an actuarial increase in the benefit is required by section 411(b), is disregarded in determining whether the amount of benefits satisfies this section.

(6) *Computation of benefits on other than plan year basis.* For purposes of this section, accruals are generally determined based on the plan year. Nevertheless, an employer may, but need not, determine accruals on the basis of any period ending within the plan year as long as the period is at least 12 months in duration and is applied uniformly to all employees in the plan for that plan year. For example, accruals for all employees can be determined based on accrual computation periods ending within the plan year.

(7) *Computation of compensation on other than plan year basis.* For purposes of this section, compensation is generally determined based on the plan year. Nevertheless, an employer may, but need not, determine compensation on the basis of any consecutive period ending within the plan year as long as it is at least 12 months in duration and is applied uniformly to all employees in the plan for that plan year. For purposes of paragraph (f)(2) of this section, the period must be at least 36 months in duration (or the employee's period of employment, if shorter).

§1.401(a)(4)-4 Nondiscriminatory availability of benefits, rights, and features.

(a) *Overview.* The availability of benefits, rights, or features provided under a plan does not discriminate in favor of highly compensated employees if the plan satisfies the requirements of this section. The benefits, rights, and features that must satisfy the requirements of this section are the optional forms of benefit, ancillary benefits, and other rights and features provided under the plan. The general requirements of this section are set forth in paragraph (b) of this section. A special rule relating to acquisitions, mergers, and similar transactions is set forth in paragraph (c) of this section. Definitions of optional forms of benefit, ancillary benefits, and other rights and features are provided in paragraphs (d), (e), and (f) of this section respectively. Paragraph (g) of this section contains special rules applicable to employees with accrued benefits who do not currently benefit under the plan. Paragraph (h) contains a cross-reference to a special rule that applies when one or more defined contribution plans and one or more defined benefit plans are combined to satisfy sections 401(a)(4) and 410(b).

(b) *Current and effective availability.* A plan satisfies section 401(a)(4) with respect to the availability of optional forms of benefit if it satisfies §1.401(a)-4 with respect to each optional form of benefit under the plan. A plan satisfies section 401(a)(4) with respect to the availability of ancillary benefits and other rights or features if each such benefit, right, or feature separately satisfies the current availability requirement of Q&A-2(a)(2)(ii) of §1.401(a)-4 and the effective availability requirement of Q&A-2(a)(3) of §1.401(a)-4.

(c) *Special rule for acquisitions, mergers, and similar transactions.* This paragraph (c) provides an exception to the general rule contained in paragraph (b) of this section in the case of optional forms of benefit or other rights or features available to a group of employees under a plan before and after their employer engages in an asset or stock acquisition, merger, or other similar transaction involving the change of control of a trade or business. If the optional form of benefit or other right or feature satisfies section 401(a)(4) and this section before the transaction and after the transaction, and continues to be made available on the same terms to those employees affected by the transaction either under the plan or under a successor plan, then the optional form of benefit or other right or feature is deemed to satisfy the requirements of paragraph (b) of this section for all subsequent plan years. This rule does not apply with respect to ancillary benefits. Further, this rule does not apply if additional employees become eligible for the optional form of benefit or the right or feature after the transaction or if there is a change in the terms of the optional form of benefit or the right or feature.

(d) *Optional form of benefit.* For purposes of this section, the term "optional form of benefit" means a distribution alternative that is available under a plan with respect to benefits described in section 411(d)(6)(A) or early retirement benefits and retirement-type subsidies described in section 411(d)(6)(B)(i). Different optional forms of benefit exist if the distribution alternative is not available on substantially the same terms. The relevant terms include all

terms affecting the value of the optional form, such as the actuarial assumptions used to determine the amount distributed or the method of benefit calculation. A distribution alternative will not be considered to be more than one optional form of benefit merely because the benefit formulas which underlie the distribution alternative are different, provided that the amount of benefits or contributions provided under the formulas satisfy the nondiscriminatory amount requirement of §1.401(a)(4)-1(b)(2) when the formulas are tested together. Different optional forms of benefit may result from differences in payment schedule, timing, commencement, medium of distribution (e.g., in cash or in kind), election rights, or the portion of the benefit to which the distribution alternative applies. This paragraph (d) is illustrated by the following examples:

Example 1. Plan B is a defined benefit plan that covers all employees of Divisions M and N. The plan offers a qualified joint and 50-percent survivor annuity at normal retirement age, calculated by multiplying an employee's single life annuity payment by a factor. For an employee of Division M whose benefit commences at age 65, the plan provides a factor of 0.90, but for a similarly situated employee of Division N the plan provides a factor of 0.85. The qualified joint and survivor annuity is not available to employees of Division M and N on substantially the same terms.

Example 2. Plan C is a defined benefit plan that covers all employees of Divisions R and S. The plan offers a single sum optional form of benefit which, for employees of Division R, is determined using a fixed interest rate assumption and, for employees of Division S, is determined using a different fixed interest rate assumption. The single sum optional form of benefit is not available to employees of Divisions R and S on substantially the same terms.

Example 3. Plan D is a defined benefit plan that covers all employees of Divisions T and U. The plan offers a single sum optional form of benefit, determined using the same actuarial assumptions, to all employees. However, different benefit formulas are provided to each division. The formulas do not satisfy §1.401(a)(4)-1(b)(2) when combined. Because the underlying benefit formulas differ and do not satisfy §1.401(a)(4)-1(b)(2) when combined, the single sum optional form of benefit available to employees of Division T is a different optional form of benefit than the single sum optional form available to employees of Division U.

(e) *Ancillary benefit.* For purposes of this section, the term "ancillary benefit" includes: social security supplements described in section 411(a)(9); disability benefits not in excess of a qualified disability benefit described in section 411(a)(9); ancillary life insurance and health insurance benefits; death benefits under a defined contribution plan; preretirement death benefits under a defined benefit plan; shut-down benefits not protected under section 411(d)(6); and other similar benefits. Different ancillary benefits exist with respect to each benefit that is not available on substantially the same terms.

(f) *Other right or feature*—(1) *Definition.* For purposes of this section, the term "other right or feature" means any right or feature applicable to employees under the plan, other than a right or feature taken into account as part of an optional form of benefit or ancillary benefit provided under the plan, and other than a right or feature that cannot reasonably be expected to be of more than insignificant value to an employee (e.g., administrative details). Different rights or features exist if the right or feature is not available on substantially the same terms.

(2) *Examples.* Other rights and features include, but are not limited to, the following:

(i) Plan loan provisions (other than those relating to a distribution of an employee's accrued benefit upon default under a loan);

(ii) The right to direct investments;

(iii) The right to a particular form of investment;

(iv) The right to a particular class or type of employer securities (taking into account any difference in conversion, dividend, voting, liquidation preference, or other rights conferred under the security);

(v) The right to make each rate of elective contributions described in §1.401(k)-1(g)(4);

(vi) The right to make each rate of employee contributions described in §1.401(m)-1(f)(7);

(vii) The right to an allocation of each rate of matching contributions described in §1.401(m)-1(f)(8) and the formulas and requirements for matching contributions;

(viii) The right to purchase additional retirement or ancillary benefits under the plan; and

(ix) The right to make rollover contributions and transfers to and from the plan.

(3) *Employee contributions to a defined benefit plan.* After-tax employee contributions to a defined benefit plan that are not allocated to separate accounts (other than to purchase ancillary benefits under the plan) satisfy this section only if the availability of these employee contributions satisfy this section and, in addition, the plan satisfies the requirements of §1.401(a)(4)-6.

(g) *Employees with accrued benefits who are not currently benefiting.* A plan must satisfy the nondiscriminatory availability requirement of §1.401(a)(4)-1(b)(3) not only with respect to employees who are currently benefiting under the plan but also with respect to employees with accrued benefits who are not currently benefiting under the plan. A plan satisfies §1.401(a)(4)-1(b)(3) with respect to this latter group of employees if any of the following requirements are met:

(1) No change in the availability of any benefit, right, or feature available to any of these employees is made after any employee ceased to benefit currently under the plan; or

(2) Any change in the availability of any benefit, right, or feature provided in plan years beginning after December 31, 1988, to any highly compensated employee with accrued benefits who is not currently benefiting under the plan is applied on a consistent basis to all other employees who have accrued benefits but are not currently benefiting under the plan; or

(3) The plan satisfies §1.401(a)-4 and this section with respect to all employees with accrued benefits regardless of whether they are currently benefiting under the plan or not.

(h) *Cross-reference.* See §1.401(a)-(4)-9 for the application of paragraph (b) of this section in cases where one or more defined contribution plans and one or more defined benefit plans are designated as a single plan pursuant to §1.410(b)-7(d).

§1.401(a)(4)-5 Plan amendments, grants of past service credit, and plan terminations.

(a) *Plan amendments*—(1) *In general.* A plan does not satisfy section 401(a)(4) if a plan amendment or series of amendments (including amendments terminating the plan) discriminates in favor of highly compensated employees. The determina-

tion of whether an amendment or series of amendments discriminates is made on the basis of all relevant facts and circumstances. These include the relative accrued benefits (expressed as a percentage of compensation) of the highly and nonhighly compensated employees before and after the effective date of the plan amendment, the relative length of service of the highly and nonhighly compensated employees, the length of time the plan or plan provisions have been in effect, the turnover of employees prior to plan amendment, and additional benefits provided to nonhighly compensated employees under other plans. A plan amendment that increases future benefits only for highly compensated employees, such as an amendment instituting use of the disparity permitted under section 401( ), does not discriminate in favor of highly compensated employees if the benefits otherwise satisfy section 401(a)(4).

(2) *Examples.* The rules of this paragraph (a) are illustrated by the following examples:

Example 1. Plan A is a defined benefit plan that covered both highly compensated and nonhighly compensated employees for most of its existence. The employer decides to wind up the business. Shortly thereafter, at a time when the plan covers only highly compensated employees, Plan A is amended to increase benefits and thereafter is terminated. Plan A does not satisfy section 401(a)(4) because the amendment increasing benefits discriminates in favor of highly compensated employees.

Example 2. Plan B is a defined benefit plan that provides a social security supplement as described in section 411(a)(9). After substantially all of the highly compensated employees of the employer have benefited from the supplement, but before a substantial number of nonhighly compensated employees have become eligible for the supplement, Plan B is amended to significantly reduce the amount of the supplement. Plan B does not satisfy section 401(a)(4) because the amendment discriminates in favor of highly compensated employees.

Example 3. Plan C is a defined benefit plan that contains an ancillary life insurance benefit available to all employees. The plan is amended to eliminate this benefit at a time when life insurance payments have been made only to beneficiaries of highly compensated employees. Because all employees received the benefit of life insurance coverage before Plan C was amended, Plan C does not fail to satisfy section 401(a)(4) as a result of the amendment.

(b) *Past service credits*—(1) *In general.* A plan does not satisfy section 401(a)(4) if plan provisions, including plan amendments, that provide past service credit have the effect of discriminating significantly in favor of highly compensated employees. Past service credit includes benefit accruals for an employee's service prior to the time a new plan is in effect, increases in existing accrued benefits resulting from an employee's service prior to the effective date of a plan amendment, and benefit accruals for service with another employer. The determination of whether these provisions cause significant discrimination is made on the basis of all relevant facts and circumstances, including employee turnover during the period to which the past service credit applies and the amount of benefits that former employees would have received had the plan or benefit increase been in effect throughout the period to which the past service credit applies. In addition, those facts and circumstances that are generally relevant to plan amendments are taken into account. See paragraph (a) of this section.

(2) *Safe harbor.* Past service credit is deemed not to discriminate significantly in favor of highly compensated employees for purposes of this section if the period for which the credit is granted does not exceed the 5 years preceding the current year and the past service credit is granted on a reasonably uniform basis to current employees under the plan. However, this safe harbor will not be available if a plan amendment granting past service credit for 5 years is part of a pattern of amendments that discriminates in favor of highly compensated employees.

(3) *Examples.* The rules in this paragraph (b) are illustrated by the following examples:

Example 1. Plan A provides for a unit benefit of 1 percent of compensation per year of service. After 10 years, Plan A is amended to provide a benefit of 2 percent of compensation per year of service, including service prior to the amendment. The amendment is effective only for employees currently employed at the time of the amendment. Current employees with prior service are primarily highly compensated employees, and there is a significant number of former nonhighly compensated employees compared to former highly compensated employees. The effect of this plan amendment is to discriminate significantly in favor of highly compensated employees.

Example 2. Assume the same facts as in Example 1, except that the years of prior service are equivalent between highly and nonhighly compensated employees who are current employees and that current employees with prior service is a category of employees that would satisfy the nondiscriminatory classification requirements of section 410(b)(2)(A)(i). This amendment does not discriminate significantly in favor of highly compensated employees.

Example 3. Employer X currently has six employees, two of whom, A and B, are highly compensated employees, and the remaining four of whom, C, D, E, and F, are nonhighly compensated employees. Employer X establishes a defined benefit plan providing a 2-percent benefit for each year of service with the employer, including service provided before the plan is established. A and B each have 15 years of prior service, C has 9 years of past service, D has 5 years, E has 3 years, and F has 1 year. The plan violates section 401(a)(4) because the grant of past service discriminates significantly in favor of highly compensated employees.

Example 4. Assume the same facts as in Example 3, except that the plan limits the past service credit to 5 years. The grant of past service credit does not discriminate significantly in favor of highly compensated employees.

Example 5. Assume the same facts as in Example 3, except that all four of the nonhighly compensated employees were hired in the current year and Employer X never employed any nonhighly compensated employees prior to the current year. Because no nonhighly compensated employees would have received additional benefits had the plan been in existence during the preceding 15 years, the grant of past service credit does not discriminate significantly in favor of highly compensated employees.

Example 6. Employer Y established a defined benefit plan covering all its employees in 1971. No past service credit was granted to Employer Y's employees at the time the plan was established. In 1990, Employer Y acquires Division B from Employer Z. Employees of Division B had been covered under a defined benefit plan maintained by Employer Z. Employer Y amends its plan to cover all employees of Division B and grants past service credit to all employees of Division B for each year of service with Employer Z beginning with 1971. Employer Y further amends its plan to provide that benefits for employees of Division B under its plan will be offset by benefits paid under the plan maintained by Employer Z. The grant of past service does not discriminate significantly in favor of highly compensated employees because Employer Y is not granting past service for any year for which other employees of Employer Y have not received credited service.

(c) *Pre-termination restrictions*—(1) *Required provisions in defined benefit plans.* A defined benefit plan must incorporate provisions restricting benefits and distributions as described in paragraphs (c)(2) and (3) of this section at the time the plan is established or, if later, the effective date of these regulations, unless the Commissioner determines that such provisions are not necessary to prevent the prohibited discrimination that may occur in the event of an early termination of the plan. Any plan containing a provision described in this paragraph (c) will meet the requirements of section

411(d)(2) and will not fail to satisfy section 411(a) or (d)(3) merely because of the provision.

(2) *Restriction of benefits.* A plan must provide that, in the event of plan termination, the benefit of any highly compensated employee (and any highly compensated former employee) is limited to a benefit that is nondiscriminatory under section 401(a)(4).

(3) *Restrictions on distributions*—(i) *Limit on annual payments.* A plan must provide that the annual payments to an employee described in paragraph (c)(3)(ii) of this section are restricted to an amount equal to the payments that would be made on behalf of the employee under a single life annuity that is the actuarial equivalent of the sum of the employee's accrued benefit and the employee's other benefits under the plan. The restrictions in this paragraph (c)(3) do not apply, however, if:

(A) After payment to an employee described in paragraph (c)(3)(ii) of this section of all benefits described in paragraph (c)(3)(iii) of this section, the value of plan assets equals or exceeds 110 percent of the value of current liabilities, as defined in section 412(l)(7), or

(B) The value of the benefits described in paragraph (c)(3)(iii) of this section for an employee described in paragraph (c)(3)(ii) of this section is less than 1 percent of the value of current liabilities.

(ii) *Employees whose benefits are restricted.* The employees whose benefits are restricted on distribution include all highly compensated employees and highly compensated former employees. In any one year, the total number of employees whose benefits are subject to restriction under this section can be limited by the plan to a group of not less than 25 highly compensated employees and highly compensated former employees. If the group of affected employees is limited by the plan, the group must consist of those highly compensated employees and highly compensated former employees with the greatest compensation. Plan provisions defining or altering the group of employees whose benefits are restricted under this paragraph (c)(3) may be amended at any time without violating the requirements of section 411(d)(6).

(iii) *"Benefit" defined.* For purposes of this paragraph (c)(3), "benefit" includes loans in excess of the amounts set forth in section 72(p)(2)(A), any periodic income, any withdrawal values payable to a living employee, and any death benefits not provided for by insurance on the employee's life.

(4) *Operational restrictions on certain money purchase pension plans.* A money purchase pension plan that has an accumulated funding deficiency, within the meaning of section 412(a), must comply in operation with the restrictions on benefits and distributions as described in paragraphs (c)(2) and (3). Restrictions imposed by the requirements of this paragraph (c)(4) are treated as not violating the requirements of section 411(d)(6).

§1.401(a)(4)-6 Defined benefit plans with employee contributions.

(a) *Overview.* This section contains rules for determining whether the nondiscriminatory amount requirement of §1.401(a)(4)-1(b)(2) is satisfied in the case of a defined benefit plan that includes employee contributions not allocated to separate accounts. A plan of this type must satisfy the nondiscriminatory amount requirement separately with respect to the benefits derived from employer contributions and the benefits derived from employee contributions. Once the amount of employer-derived benefits has been determined under the plan, those benefits must satisfy the requirements of §1.401(a)(4)-1(b)(2) without regard to any employee-derived benefits under the plan. Paragraph (b) of this section provides rules for determining the respective amount of employer-derived benefits and employee-derived benefits under a plan. Paragraph (c) of this section provides the exclusive rules for determining whether the employee-derived benefits under the plan attributable to employee contributions not allocated to separate accounts satisfy the nondiscriminatory amount requirement of §1.401(a)(4)-1(b)(2). Paragraph (d) of this section contains a cross-reference to the rules applicable to the amount of employee contributions that are allocated to separate accounts under a plan.

(b) *Determination of employer-derived and employee-derived benefits*—(1) *In general.* An employee's employer-derived benefit equals the difference between the employee's total benefit and the portion of the employee's benefit derived from employee contributions (the employee-derived benefit). Paragraphs (b)(2) through (5) of this section provide simplified rules that may be used to determine the employee-derived benefit. If none of those alternatives is used, the employee-derived benefit is determined separately for each employee in accordance with section 411(c).

(2) *Composition-of-work-force method.* The employee-derived benefit may be determined in accordance with the rules of §1.401(l)-3(g)(2). In general, under the rules of that section, if the ages of highly compensated employees under the plan are not significantly greater than the ages of nonhighly compensated employees under the plan, the employee-derived benefit may be calculated using the uniform factors prescribed in §1.401(l)-3(g)(2)(vi).

(3) *Minimum benefit method*—(i) *Uniform factors.* If the plan provides the minimum benefit described in paragraph (b)(3)(ii) of this section, the employee-derived benefit may be determined for purposes of this section by using the uniform factors in paragraphs (b)(3)(i)(A) and (B) of this section. These factors may also be used for purposes of section 401(l).

(A) *Final average compensation formula.* The uniform factor for a plan that contains a final average compensation formula, as defined in §1.401(l)-3(g)(2)(vi), is equal to 40 percent of the rate of employee contributions, expressed as a percentage of compensation. Thus, a defined benefit plan containing a final average compensation formula and requiring an employee contribution of 1 percent of compensation produces an employee-derived benefit equal to 0.4 percent of final average compensation times years of service.

(B) *Career average compensation formula.* The uniform factor for a plan that contains a career average compensation formula, as defined in §1.401(l)-3(g)(2)(vi), is equal to 60 percent of the rate of employee contributions, expressed as a percentage

of compensation. Thus, a defined benefit plan containing a career average compensation formula and requiring an employee contribution of 1 percent of compensation produces an employee-derived benefit equal to 0.6 percent of career average compensation times years of service.

(ii) *Minimum benefit.* A plan satisfies this paragraph (b)(3)(ii) if it provides that in plan years beginning after December 31, 1990, each employee will accrue a benefit that equals or exceeds the sum of—

(A) The accrued benefit derived from employee contributions made for plan years beginning after December 31, 1990, determined in accordance with section 411(c), and

(B) Fifty percent of the total benefit accrued in planyears beginning after December 31, 1990, as determined under the plan benefit formula without regard to that portion of the formula designed to satisfy the minimum benefit requirement of this paragraph (b)(3)(ii).

(iii) *Example.* The rules in this paragraph (b)(3) are illustrated by the following example:

Example. Plan D is a calendar year defined benefit plan that determines benefits based on a final average compensation formula and requires employee contributions as a condition of participation. For the 1991 plan year, Employee A's benefit accrual under the terms of the plan without regard to the minimum benefit requirement of paragraph (b)(3)(ii) is $3,000. The portion of Employee A's benefit accrual for 1991 derived from employee contributions is $2,000, determined by applying the rules of section 411(c) to such contributions. The requirement of paragraph (b)(3)(ii) is not satisfied for the 1991 plan year unless the plan provides that Employee A's benefit accrual for 1991 is equal to $3,500 ($2,000 plus 50 percent of $3,000). If Plan D provides the minimum benefit required under paragraph (b)(3)(ii), then it may use the factor in paragraph (b)(3)(i)(A) to determine Employee A's employee-derived benefit.

(4) *Government plan method.* A plan that includes employee contributions not allocated to separate accounts and that is established and maintained for its employees by the government of any state or political subdivision or by any agency or instrumentality thereof may treat all benefits as employer-derived benefits.

(5) *Cessation of employee contributions method.* If a plan provides that no employee contributions, other than employee contributions allocated to separate accounts, may be made to the plan for plan years beginning after December 31, 1990, the plan may treat all benefits under the plan (other than benefits attributable to employee contributions allocated to separate accounts) as employer-derived.

(c) *Employee contributions not allocated to separate accounts*—(1) *In general.* A defined benefit plan generally satisfies section 401(a)(4) with respect to the amount of benefits derived from employee contributions not allocated to separate accounts only if the plan satisfies the requirements of paragraphs (c)(2), (3), or (4) of this section.

(2) *General rule.* A defined benefit plan satisfies the requirements of this paragraph (c)(2) if the employee contributions are made at the same rate, expressed as a percentage of compensation, by all employees under the plan.

(3) *Total benefits method.* A defined benefit plan satisfies the requirements of this paragraph (c)(3) if:

(i) The total benefits (i.e., the sum of employer-derived and employee-derived benefits) under the plan would satisfy §1.401(a)(4)-3 if all benefits were treated as employer-derived benefits, and

(ii) The plan requires a higher rate of employee contributions with respect to compensation above a stated level of compensation than is required below that level.

(4) *Grandfather rule for plans in existence on May 14, 1990.* A plan in existence on May 14, 1990, satisfies the requirements of this paragraph (c)(4) with respect to the employee-derived benefit under the plan if the following requirements are met:

(i) On May 14, 1990, the plan requires employee contributions at a greater rate at higher levels of compensation;

(ii) The employee contribution rate for required employee contributions is not increased after May 14, 1990 (although the level of compensation at which employee contributions are required may be increased or decreased);

(iii) For plan years beginning after December 31, 1990, all employees under the plan are permitted to make employee contributions at a uniform rate with respect to all compensation under the plan; and

(iv) The benefits provided on account of employee contributions at lower levels of compensation are comparable to those provided on account of employee contributions at higher levels of compensation. Employee-derived benefits described in this paragraph (c)(4)(iv) can be disregarded in determining whether employer-derived benefits satisfy §1.401(a)(4)-3.

(d) *Employee contributions allocated to separate accounts.* A defined benefit plan satisfies section 401(a)(4) with respect to the amount of employee contributions that are allocated to a separate account only if those contributions satisfy the requirements of section 401(m) and §1.401(a)(4)-2(d).

§1.401(a)(4)-7 Effect of section 401(l) permitted disparity.

(a) *Overview*—(1) *In general.* In determining whether a plan satisfies section 401(a)(4) with respect to the amount of contributions or benefits, the disparity permitted under section 401(l) may be taken into account. Methods under which the contribution or benefit formula under a single plan can satisfy section 401(l) in form are contained in §§1.401(l)-2 and 1.401(l)-3. Alternatively, the permitted disparity may be arithmetically imputed to each employee's accrual or allocation rate in order to determine an adjusted accrual or allocation rate that appropriately accounts for the permitted disparity. This section contains the exclusive methods for imputing permitted disparity.

(2) *Scope.* Paragraph (b) of this section provides rules for imputing permitted disparity with respect to contributions. Paragraph (c) of this section provides rules for imputing permitted disparity with respect to benefits. Paragraph (d) of this section contains rules regarding plans eligible to impute permitted disparity, the treatment of multiple plans, relationship to other adjustments, transitional rules, and compensation.

(b) *Defined contribution plans*—(1) *In general.* This paragraph (b) provides rules for adjusting allocation rates under §1.401(a)(4)-2, §1.401(a)(4)-8, or §1.401(a)(4)-9 to take into account permitted disparity. These rules produce an adjusted allocation rate for each employee by determining the excess contribution percentage

under the hypothetical formula that would yield the allocation actually received by the employee, if the plan took into account the full permitted disparity under section 401(l)(2) and used the taxable wage base as the integration level. The excess contribution percentage under the formula is the adjusted allocation rate. This adjusted rate is used to determine whether the amount of contributions under the plan satisfies §1.401(a)(4)-2 and to apply the average benefit percentage test of section 410(b)(2)(A)-(ii). Paragraph (b)(2) of this section applies to employees with compensation not exceeding the taxable wage base, and paragraph (b)(3) of this section applies to employees with greater compensation.

(2) *Compensation not exceeding taxable wage base*—(i) *Formula.* If an employee's compensation does not exceed the taxable wage base in effect as of the beginning of the plan year, the employee's adjusted allocation rate equals the sum of:

(A) The employee's actual allocation rate (expressed as a percentage of compensation), determined under §1.401(a)(4)-2(c) (without regard to paragraphs (c)(4) and (5) of that section), §1.401(a)(4)-8, or §1.401(a)-(4)-9, whichever is applicable, without regard to this section, and

(B) The lesser of the rate determined under paragraph (b)(2)(i)(A) of this section and the rate determined under section 401(l)(2)(ii) and §1.401(l)-2(b)(5)(ii) (e.g., 5.7 percent in 1990).

(ii) Example. If an employee with compensation of $30,000 in the 1990 plan year receives an allocation of $1,500, the employee's adjusted allocation rate is 10 percent, which equals the sum of the actual allocation rate (5 percent) and the lesser of that 5 percent or the 5.7 percent provided under §1.401(l)-2(b)(5)(ii).

(3) *Compensation exceeding taxable wage base*—(i) *Formula.* If an employee's compensation exceeds the taxable wage base in effect as of the beginning of the plan year, the employee's adjusted allocation rate is the lesser of the rates determined under the formulas below, where allocations are determined as the dollar amount of allocations taken into account under §1.401(a)(4)-2(c)(2) for the plan year with respect to the employee:

$$\text{A Rate} = \frac{\text{allocations}}{\text{compensation} - \frac{1}{2}\text{ taxable wage base}}$$

$$\text{B Rate} = \frac{\text{allocations} + (\text{section 401(l)(2)(A)(ii) rate} \times \text{taxable wage base})}{\text{compensation}}$$

(ii) *Example.* Employee B has compensation of $100,000 in the 1990 plan year. Employee B participates in a profit-sharing plan and receives an allocation of $8,000 for the plan year. Assume the taxable wage base in 1990 is $50,000. B's adjusted allocation rate is 10.67 percent, which is the lesser of 10.67 percent ($8,000 divided by ($100,000 - (1/2 X $50,000))) and 10.85 percent (($8,000 + (5.7 percent X $50,000)) divided by $100,000).

(c) *Defined benefit plans*—(1) *In general.* This paragraph (c) provides rules for adjusting benefit accrual rates under §1.401(a)(4)-3, §1.401(a)-(4)-8, or §1.401(a)(4)-9 to take into account permitted disparity. These rules produce an adjusted benefit accrual rate for each employee by determining the excess benefit percentage rate under the hypothetical plan formula that would yield the employer-derived accrual actually received by the employee, if the plan took into account the full permitted disparity under section 401(l)(4)(A) and used the employee's covered compensation as the integration level. The excess benefit percentage under the formula so determined is the adjusted benefit accrual rate. This adjusted rate is used to determine whether the amount of benefits under the plan satisfies §1.401(a)(4)-3 and to apply the average benefit percentage test of section 410(b)(2)(A)(ii). Paragraph (c)(2) of this section applies to employees with compensation not exceeding covered compensation, and paragraph (c)(3) of this section applies to employees with greater compensation. The compensation used to determine these rates is determined under the rules in paragraphs (c)(5)(v) and (d)(5) of this section. Paragraph (c)(5) of this section provides definitions and rules of application.

(2) *Compensation not exceeding covered compensation.* If an employee's compensation does not exceed the employee's covered compensation as of the beginning of the plan year, the employee's adjusted benefit accrual rate equals the sum of:

(i) The employee's actual accrual rate, determined under §1.401(a)-(4)-3, §1.401(a)(4)-8, or §1.401(a)-(4)-9 whichever is applicable, with respect to employer-derived benefits, and

(ii) The lesser of the rate determined under paragraph (c)(2)(i) of this section and the permitted disparity factor under paragraph (c)(5)(i) of this section.

(3) *Compensation exceeding covered compensation.* If an employee's compensation exceeds the employee's covered compensation as of the beginning of the plan year, the employee's adjusted benefit accrual rate is the lesser of the rates determined under the formulas below using the appropriate disparity factor under paragraph (c)(5)(i) of this section:

$$\text{A Rate} = \frac{\text{accrual with respect to employer-derived benefits}}{\text{compensation} - \frac{1}{2}\text{ covered compensation}}$$

$$\text{B Rate} = \frac{\text{accrual with respect to employer-derived benefits} + (\text{permitted disparity factor} \times \text{covered compensation})}{\text{compensation}}$$

(4) *Example.* The rules in paragraph (c)(2) and (3) of this section are illustrated by the following example:

Example. (i) Employees C and D participate in a defined benefit plan maintained by Employer X, with a normal retirement age of 65. Employee C's accrued benefit is $2,000 as of 1993 and $2,310 as of 1994. The average of Employee C's high three years' compensation is $20,000 as of the 1993 plan year and $21,000 as of the 1994 plan year. Employee D's accrued benefit is $16,000 as of 1993 and $18,500 as of 1994. The average of Employee D's high three years' compensation is $100,000 as of the 1993 plan year and $106,000 as of the 1994 plan year. The covered compensation of both Employees C and D is $25,000, and both Employees C and D's social security retirement age under the plan is 65. The employer is testing the plan under §1.401(a)(4)-3 and is determining accrual rates under the annual method.

(ii) Employee C's adjusted accrual rate is determined as follows: Employee C's actual accrual rate is equal to 11 percent (Employee C's benefit in 1994 expressed as a percentage of 1994 compensation) minus 10 percent (Employee C's benefit in 1993 expressed as a percentage of 1993 compensation), or 1 percent. Since Employee C's compensation is less than his covered compensation, Employee C's adjusted benefit accrual rate is 1.75 percent, the lesser of 1 percent plus 1 percent and 1 percent plus 0.75 percent.

(iii) Employee D's adjusted accrual rate is determined as follows: Employee D's actual accrual rate is equal to 17.45 percent (Employee D's benefit in 1994 expressed as a percentage of 1994 compensation) minus 1 percent (Employee D's benefit in 1993 expressed as a percentage of 1993 compensation), or 1.45 percent. Employee D's accrual for the year is 1.45 percent times $106,000, or $1,537.

Since Employee D's compensation is more than covered compensation, Employee D's adjusted benefit accrual rate is 1.63 percent, the lesser of 1.64 percent ($1,537 divided by ($106,000 minus (0.5 X $25,000))) and 1.63 percent (($1,537 + (0.75 percent X $25,000)) divided by $106,000).

(5) *Definitions and rules of application*—(i) *Permitted disparity factor.* Except as otherwise provided, an employee's permitted disparity factor is 0.75 percent reduced, pursuant to §1.401(a)-3(e), with respect to benefits commencing prior to the employee's social security retirement age. For this purpose, the benefit commences at the age at which the benefit is being tested. For example, if a most valuable annuity is converted to and tested as a normalized annuity at age 65, the permitted disparity factor is 0.75 percent, even though the most valuable annuity would actually commence at an earlier age. Generally, if a plan has a normal retirement age of 65, the permitted disparity factor for a benefit commencing at normal retirement age is 0.75 percent for an individual whose social security retirement age is 65, is 0.70 percent for an individual whose social security retirement age is 66, and is 0.65 percent for an individual whose social security retirement age is 67. A plan is permitted to treat the permitted disparity factor with respect to all employees (of whatever age) as the factor for an employee whose social security retirement age is 67. Thus, if benefits commence at age 65, the plan may use 0.65 percent for all employees. No reductions are made in the permitted disparity factor except for benefits commencing before the employee's social security retirement age.

(ii) *Annual method.* If benefit accrual rates are determined under the annual method of §1.401(a)(4)-3(c)(3)(ii), §1.401(a)(4)-8(b)(2), or §1.401(a)(4)-9(c)(2)(ii)(A), the following rules apply to the determination of adjusted benefit accrual rates under paragraph (c) of this section:

(A) *Actual accrual rates.* An employee's actual accrual rate is the rate determined (as a percentage of compensation and without regard to permitted disparity) under §1.401(a)(4)-3(c)(3)(ii), §1.401(a)(4)-8(b)(2), or §1.401(a)(4)-9(c)(2)(ii)(A), whichever is applicable.

(B) *Determination of employee's accrual.* An employee's accrual is equal to the employee's compensation multiplied by the employee's normal or most valuable accrual rate (expressed as a percentage of compensation), whichever is being tested, with respect to employer-derived benefits, determined under the annual method of §1.401(a)(4)-3(c)(3)(ii), §1.401(a)(4)-8(b)(2), or §1.401(a)(4)-9(c)(2)(ii)(A), whichever is applicable.

(C) *Adjustment to permitted disparity factor for employee with more than 35 years.* In the case of an employee with more than 35 years of credited service under any plan of the employer, the permitted disparity factor for the current plan year is 0.

(iii) *Accrued-to-date method.* If benefit accrual rates are determined under the accrued-to-date method of §1.401(a)(4)-3(c)(3)(iii), §1.401(a)(4)-8(b)(2), or §1.401(a)(4)-9(c)(2)(ii)(B), the following rules apply to the determination of adjusted benefit accrual rates under paragraph (c) of this section:

(A) Actual accrual rates. An employee's actual accrual rate is the rate determined (as a percentage of compensation, and without regard to permitted disparity) under §1.401(a)(4)-3(c)(3)(iii), §1.401(a)(4)-8(b)(2), or §1.401(a)(4)-9(c)(2)(ii)(B), whichever is applicable.

(B) *Determination of employee's accrual.* The employee's accrual is the employee's total employer-derived accrued benefit (expressed as the normal retirement benefit or the most valuable benefit, whichever is being tested), divided by the employee's number of years of credited service.

(C) *Determination of permitted disparity factor.* The permitted disparity factor is equal to the permitted disparity factor for the employee under the plan in the current year (determined under the annual method and without regard to paragraph (c)(5)(ii)(C) of this section) multiplied by the employee's number of years of credited service (not to exceed 35), and then divided by the employee's total number of years of credited service.

(iv) *Projected method.* If benefit accrual rates are determined under the projected method of §1.401(a)(4)-3(c)(3)(iv), the following rules apply to the determination of adjusted benefit accrual rates under paragraph (c) of this section—

(A) *Actual accrual rates.* An employee's actual accrual rate is the rate determined (as a percentage of compensation and without regard to permitted disparity) under §1.401(a)(4)-3(c)(3)(iv).

(B) *Determination of employee's accrual.* The employee's accrual is the employee's total employer-derived projected accrued benefit (expressed as the normal retirement benefit or the most valuable benefit, whichever is being tested), divided by the employee's projected number of years of credited service.

(C) *Determination of permitted disparity factor.* The permitted disparity factor is equal to the permitted disparity factor for the employee under the plan in the current year (determined under the annual method and without regard to paragraph (c)(5)(ii)(C) of this section) multiplied by the employee's projected number of years of credited service (not to exceed 35), and then divided by the employee's projected total number of years of credited service.

(v) *Definitions.* For purposes of this section, the terms "compensation" and "covered compensation" have the meaning provided in §1.401(l)-1(b)(6) and (9) respectively. The permitted disparity factor under a defined benefit plan is determined in accordance with §1.401(l)-3.

(d) *Special rules*—(1) *Eligible plans.* The rules in this section may be used only for those plans to which the permitted disparity rules of section 401(l) are available. Therefore, these rules may generally not be used, for example, by an ESOP or with respect to contributions subject to section 401(k) or (m). See §1.401(l)-1(a)(3) for other plans to which section 401(l) is not available.

(2) *Multiple integration.* The permitted disparity limits of section 401(l) and this section apply to the contributions and benefits of an employee under all plans of an employer. Thus, if the full permitted disparity under section 401(l) has been taken into account with respect to an employee's benefits under a plan, no additional disparity is permitted with respect to the employee under any

other plan of the employer. Rules explaining how the total permitted disparity with respect to an employee may be divided among two or more plans maintained by an employer are contained in §1.401(l)–4.

(3) *Relationship to other adjustments.* Permitted disparity is imputed under this section after taking into account the value of any includible disability benefits under §1.401(a)(4)–3(d) or §1.401(a)(4)–8(c)(4), and before grouping allocation or accrual rates under §1.401(a)(4)–2(c)(5) or §1.401(a)(4)–3(c)(3)(v).

(4) *Transition rules*—(i) *Scope.* This paragraph (d)(4) provides rules that are applicable to a plan that was in existence prior to the first plan year beginning before January 1, 1989, that uses either the accrued-to-date method or the projected method under paragraph (c)(5)(iii) or (iv) of this section to impute disparity, and that applies such methods solely with respect to benefits accrued and participation in plan years beginning after a selected date no later than December 31, 1990. A plan described in this paragraph (d)(4) must make the adjustments described below for determining the years of credited service taken into account in calculating each employee's accrual and permitted disparity factor.

(ii) *Accrued-to-date method*—(A) *Substitute rules.* In determining the adjusted benefit accrual rates under the accrued-to-date method under paragraph (c)(5)(iii) of this section, the rules in (B) and (C) below are substituted, respectively, for the rules in paragraph (c)(5)(iii)(B) and (C) of this section.

(B) *Determination of employee's accrual.* The employee's accrual is the employee's total employer-derived accrued benefit (expressed as the normal retirement benefit or the most valuable benefit, whichever is being tested), divided by the employee's number of years of credited service after the selected date.

(C) *Determination of permitted disparity factor.* The permitted disparity factor is equal to the permitted disparity factor for the employee under the plan in the current year (determined under the annual method and without regard to paragraph (c)(5)(ii)(C) of this section) multiplied by the employee's number of years of credited service after the selected date (not to exceed 35 minus the employee's years of credited service prior to the selected date), and then divided by the employee's total number of years of credited service after the selected date.

(iii) *Projected method*—(A) *Substitute rules.* In determining the adjusted benefit accrual rates under the projected method under paragraph (c)(5)(iv) of this section, the rules in (B) and (C) below are substituted, respectively, for the rules in paragraph (c)(5)(iv)(B) and (C) of this section.

(B) *Determination of employee's accrual.* The employee's accrual is the employee's total employer-derived projected accrued benefit (expressed as the normal retirement benefit or the most valuable benefit, whichever is being tested), divided by the employee's projected number of years of credited service after the selected date.

(C) *Determination of permitted disparity factor.* The permitted disparity factor is equal to the permitted disparity factor for the employee under the plan in the current year (determined under the annual method and without regard to paragraph (c)(5)(ii)(C) of this section) multiplied by the employee's projected number of years of credited service after the selected date (not to exceed 35 minus the employee's years of credited service prior to the selected date), and then divided by the employee's projected total number of years of credited service after the selected date.

(5) *Compensation*—(i) *Application of section 401(l) definition.* For purposes of applying the rules of paragraph (c) of this section, compensation must be determined in the same manner as average annual compensation is determined under section 401(l)(5)(C) in the case of a plan satisfying section 401(l)(2)(A). See §1.401(l)–1(b)(7) for the definition of average annual compensation. Thus, in determining adjusted benefit accrual rates under a plan, each employee's compensation must be based on compensation averaged over a period of at least 3 consecutive years and the period must be uniform for all employees.

(ii) *Application to amounts testing.* A plan that imputes permitted disparity with respect to benefits must determine compensation in the same manner that compensation is determined under paragraph (c) of this section for purposes of applying sections 401(a)(4) and 410(b)(2)(A)(ii) to the amount of contributions or benefits under the plan.

§1.401(a)(4)–8 Conversion of contributions and benefits.

(a) *In general.* A plan satisfies section 401(a)(4) only if it does not discriminate in favor of highly compensated employees with respect to the amount of contributions or benefits. Whether a defined contribution plan satisfies this requirement is generally determined with respect to the amount of contributions. As an alternative, however, a defined contribution plan (other than an ESOP or a plan that is subject to section 401(k) or 401(m)) may be tested with respect to the equivalent amount of benefits as set forth in paragraph (b) of this section. Similarly, whether a defined benefit plan satisfies this requirement is generally determined with respect to the amount of benefits. As an alternative, however, a defined benefit plan may be tested with respect to the equivalent amount of contributions as set forth in paragraph (c) of this section. Paragraphs (b)(4) and (d) of this section also contain safe harbor testing methods for target benefit plans and for defined benefit plans that are part of a floor-offset arrangement.

(b) *Nondiscriminatory benefits under a defined contribution plan*—(1) *In general.* A defined contribution plan (other than an ESOP or a plan that is subject to section 401(k) or 401(m)) satisfies section 401(a)(4) with respect to an equivalent amount of benefits if the equivalent benefit accrual rates under the plan satisfy §1.401(a)(4)–3(c)(1). For purposes of applying the rules in that section, an employee's equivalent benefit accrual rate determined under this paragraph (b) is treated as both the employee's normal and the employee's most valuable accrual rate. Contributions under a defined contribution plan are generally converted to equivalent benefit accrual rates using the method in paragraph (b)(2) of this section. Paragraph (b)(3) of this section contains an optional rule for determining equivalent benefit accrual rates. Paragraph (b)(4) of this section contains a

safe harbor testing method for target benefit plans.

(2) *Calculation of equivalent benefit accrual rates.* Amounts allocated to an employee's account under a defined contribution plan for a given plan year are generally converted to an equivalent benefit accrual rate as follows:

(i) Determine the dollar amount of the allocations taken into account under §1.401(a)(4)-2(c)(2) for the plan year with respect to the employee.

(ii) Calculate the present value of the amount determined under paragraph (b)(2)(i) of this section as of a selected testing age, assuming the amount earns interest, compounded no less frequently than annually, at a reasonable rate for each year until the year in which the testing age occurs. The testing age selected must be the same for all employees under the plan.

(iii) Convert the amount determined under paragraph (b)(2)(ii) of this section to a single life annuity commencing at the testing age, using a reasonable annuity factor based on the testing age. Annuity factors will be treated as reasonable for this purpose only if they are based on interest rates and mortality tables described in §1.401(a)(4)-3(c)(2)(iv)(B) and (C) and are applied on a consistent basis to all employees under the plan.

(iv) Express the annual payment under the annuity determined under paragraph (b)(2)(iii) of this section either as a dollar amount or as a percentage of the employee's compensation for the plan year.

(v) If the permitted disparity rules of section 401(l) are available with respect to a plan, the employer may, but need not, impute permitted disparity using the annual method in §1.401(a)(4)-7(c). In this case, the amounts determined under paragraph (b)(2)(iv) of this section are substituted for the employee's actual accrual or actual accrual rate. If permitted disparity is taken into account, it must be taken into account consistently with respect to all employees under the plan.

(3) *Option to use accrued-to-date method*—(i) *In general.* A method analogous to the accrued-to-date method in §1.401(a)(4)-3(c)(3)(iii) may, but need not, be used to determine an employee's equivalent benefit accrual rate. If this method is used, an employee's equivalent benefit accrual rate is calculated by substituting the employee's adjusted account balance, divided by years of participation in the plan, for the amount determined under paragraph (b)(2)(i) of this section. If this method is used, it must be used consistently for all employees under the plan and, if permitted disparity is imputed, the accrued-to-date method under §1.401(a)(4)-7(c) must be used. The method provided in this paragraph (b)(3)(i) may, but need not, be applied solely with respect to participation, and adjusted account balances attributable to allocations accrued, in plan years beginning after a selected date no later than December 31, 1990, which date is the same for all employees in the plan.

(ii) *Adjusted account balance.* For purposes of this paragraph (b)(3), an employee's adjusted account balance is the employee's actual account balance attributable to allocations described in §1.401(a)(4)-2(c)(2) for all plan years taken into account under this paragraph (b)(3), plus the additional amount that would have been provided by any prior distributions from such portion of the account balance (including an adjustment for interest that would have been earned with respect to these distributions calculated at a reasonable rate of interest consistent with the investment performance of the plan). An employer may disregard distributions from the account balance made in plan years beginning before a selected date no later than January 1, 1986, which date is the same for all employees in the plan. In addition, distributions to nonhighly compensated employees are not required to be added back.

(4) *Special rule for target benefit plans*—(i) *Safe harbor.* Whether a target benefit plan satisfies section 401(a)(4) with respect to the amount of equivalent benefits is generally determined under paragraphs (b)(1) through (3) of this section. However, a target benefit plan described in paragraph (b)(4)(ii) is deemed to satisfy section 401(a)(4) with respect to the amount of equivalent benefits if the targeted benefit formula would satisfy either of the safe harbors in §1.401(a)(4)-3(b)(2) or (3), and the interest rate used in determining contributions is not less than 7.5 percent nor more than 8.5 percent. A target benefit plan will not fail to satisfy this safe harbor solely due to minimum contributions required under section 416.

(ii) *Eligible target benefit plans.* A target benefit plan is eligible to use the safe harbor in this paragraph (b)(4) if it is a money purchase pension plan with the following characteristics:

(A) The plan provides contributions based on a stated benefit commencing at the plan's normal retirement age;

(B) Contributions necessary to fund the stated benefit for an employee are determined under either the unit credit funding method or the individual level premium funding method, and are determined assuming that future compensation remains constant;

(C) Forfeitures under the plan are applied to reduce contributions;

(D) The benefits are provided solely from contributions and forfeitures to fund the stated benefit, employee contributions, and any income, expenses, gains and losses allocated to the participant's account; and

(E) Stated benefits and contributions after normal retirement age satisfy paragraph (b)(4)(iii) of this section.

(iii) *Post normal retirement date accruals*—(A) *Unit credit plans.* This paragraph (b)(4)(iii) is satisfied by a unit credit target benefit plan being tested under §1.401(a)(4)-3(b)(2) if the amount of the stated benefit and contributions to fund the stated benefit under the plan satisfy paragraphs (b)(4)(iii)(A)(1), (2), and (3) of this section. Except as specifically provided below, these amounts are determined in the same manner as in years before the employee attained normal retirement age.

(*1*) *Plans limiting years of credited service.* If the plan limits the number of years of credited service taken into account in determining the stated benefit, contributions continue to be made to fund the stated benefit, but only for employees with less than the maximum period of service.

(*2*) *Plans not limiting years of credited service.* If the plan does not limit the number of years of credited service taken into account in determin-

ing the stated benefit, contributions continue to be made to fund the stated benefit after employees have attained normal retirement age.

(3) *Benefit increases.* The plan may increase the stated benefits for years of service after normal retirement age if the benefit increase and the required contributions to fund the benefit increase are determined in the same manner for all employees. In addition, the stated benefit may be increased to reflect increases in compensation, and contributions may be made to the extent that required contributions for any prior years were limited by section 415(c) or (e).

(B) *Flat benefit plans.* This paragraph (b)(4)(iii) is satisfied by a flat benefit target benefit plan being tested under §1.401(a)(4)-3(b)(3) if the amount of the stated benefit and contributions to fund the stated benefit under the plan satisfy the requirements in paragraphs (b)(4)(iii)(A)(1) and (2) of this section. In addition, the stated benefit may be increased to reflect increases in compensation, and contributions may be made to the extent that required contributions for any prior years were limited by section 415(c) or (e).

(C) *Plans containing employee contributions.* [Reserved.]

(c) *Nondiscriminatory contributions under a defined benefit plan*—(1) *In general.* A defined benefit plan satisfies section 401(a)(4) with respect to an equivalent amount of contributions if both the equivalent normal allocation rates and the equivalent most valuable allocation rates under the plan satisfy §1.401(a)(4)-2(c)(1). However, a defined benefit plan with a uniform formula (as defined in §1.401(a)(4)-3(c)(1)(ii)) need only be tested with respect to the equivalent most valuable allocation rate. Normal and most valuable benefits under a defined benefit plan are generally converted to equivalent normal and most valuable allocation rates using the methods in paragraphs (c)(2) and (c)(3) of this section, respectively. Paragraph (c)(4) of this section provides an optional rule that permits certain disability benefits to be taken into account.

(2) *Calculation of equivalent normal allocation rate.* An employee's benefits under a defined benefit plan for a plan year are generally converted to an equivalent normal allocation rate as follows:

(i) Calculate the employee's normal form accrual for the plan year. An employee's normal form accrual for a plan year is the difference between the employee's accrued normal retirement benefit as of the close of the plan year and the employee's accrued normal retirement benefit as of the close of the prior plan year. For this purpose, the employee's normal retirement benefit is the annual dollar amount of employer-provided benefits payable in the form of a single life annuity commencing at normal retirement age for all employees, as determined under §1.401(a)(4)-3(c)-(2)(ii). The general rule in §1.401(a)(4)-6(b)(1) must be used to determine the amount of the employee's normal retirement benefit attributable to employer contributions.

(ii) Calculate the present value, as of the close of the plan year, of the annual payment determined under paragraph (c)(2)(i) of this section. An interest rate that is not less than 7.5 percent nor more than 8.5 percent and a reasonable annuity factor based on the benefit commencement age must be used. Annuity factors will be treated as reasonable for this purpose only if they are based on interest rates and mortality tables described in §1.401(a)(4)-3(c)(2)(iv)(B) and (C).

(iii) Express the amount determined under paragraph (c)(2)(ii) of this section as a dollar amount or as a percentage of the employee's compensation for the plan year.

(iv) If the permitted disparity rules of section 401(l) are available with respect to a plan, the employer may impute disparity using the method in §1.401(a)(4)-7(b). In this case, the amounts determined under paragraph (c)(2)(iii) of this section are substituted for the employee's actual allocation or actual allocation rate. If permitted disparity is taken into account, it must be taken into account consistently for all employees under the plan.

(3) *Calculation of equivalent most valuable allocation rate.* An employee's benefits under a defined benefit plan are converted to an equivalent most valuable allocation rate using the method set forth in paragraph (c)(2) of this section, and substituting the employee's most valuable annuity determined under §1.401(a)(4)-3(c)-(2)(iii) for the normal retirement benefit. In the case of a defined benefit plan with a uniform formula as defined in §1.401(a)(4)-3(c)(1)(ii), an employee's most valuable annuity is determined without regard to the special rule in that section which assumes that each employee in the plan satisfies any service requirement to receive a benefit payable before normal retirement age.

(4) *Option to take value of disability benefits into account.* The value of disability benefits provided under a defined benefit plan may be taken into account in determining an employee's equivalent normal and most valuable allocation rates using the method provided in §1.401(a)(4)-3(d). Thus, if the requirements of that section are satisfied, the accruals determined under paragraph (c)(2)(i) of this section with respect to both an employee's normal retirement benefit and the employee's most valuable annuity may be multiplied by the factors provided in §1.401(a)(4)-3(d), before the employee's equivalent normal and most valuable allocation rates, respectively, are calculated. If this method is used, it must be used consistently for all employees under the plan.

(d) *Safe harbor for defined benefit plans that are part of a floor-offset arrangement*—(1) *In general.* A floor-offset arrangement is an arrangement pursuant to which benefits under a defined benefit plan are reduced by reference to an employee's account balance under a defined contribution plan. Generally, a defined benefit plan that is part of a floor-offset arrangement satisfies the nondiscriminatory amount requirement of §1.401(a)(4)-1(b)(2) only if the net benefit provided under the plan (i.e., the nominal benefit minus the offset) can be shown to be nondiscriminatory in amount on either a contributions or a benefits basis. However, if the floor-offset arrangement meets the requirements of paragraph (d)(2) of this section, the defined benefit plan is permitted to satisfy the nondiscriminatory amount requirement on a benefits basis without taking into account the offset applied under the plan.

(2) *Safe harbor.* A defined benefit plan that is part of a floor-offset arrangement satisfies the nondiscriminatory amount requirement of §1.401(a)(4)-1(b)(2) if:

(i) Pursuant to the floor-offset arrangement, benefits under the defined benefit plan are reduced solely by the actuarial equivalent of all or part of the vested portion of an employee's account balance under a defined contribution plan maintained by the same employer (plus the additional amount that would have been provided by any prior distributions from the account balance, including an adjustment for interest that would have been earned with respect to prior distributions calculated at the rate specified in the plan for determining the amount of the offset);

(ii) The defined benefit plan and the defined contribution plan cover the same group of employees;

(iii) The offset under the defined benefit plan is applied to all employees in the plan on the same terms;

(iv) All employees have available to them under the defined contribution plan the same investment options and the same options with respect to the timing of preretirement distributions;

(v) The defined benefit plan satisfies §1.401(a)(4)-3 without taking into account the offset described in paragraph (d)(2)(i) of this section;

(vi) The defined contribution plan satisfies §1.401(a)(4)-2; and

(vii) The rules of §1.401(a)(4)-9 are not applied with respect to either of the plans, except to the extent necessary to restructure the plans on a consistent basis to satisfy paragraph (d)(2)(ii), (iii), and (iv) of this section.

§1.401(a)(4)-9 Definition of a plan, plan aggregation, and restructuring.

(a) *In general.* Section 401(a)(4) must generally be satisfied separately by each plan maintained by an employer. Under some circumstances, however, two or more plans must satisfy section 401(a)(4) on an aggregated basis. Plans aggregated in this manner are referred to in this section as aggregated plans. In addition, a plan or aggregated plan may be restructured into component plans that are separately tested under section 401(a)(4). Paragraph (b) of this section sets forth the general definition of a plan for purposes of section 401(a)(4). Paragraph (c) of this section provides rules for determining when plans are aggregated for testing purposes and special rules for applying section 401(a)(4) to aggregated plans. Paragraph (d) of this section provides rules for restructuring plans into component plans and special rules for applying section 401(a)(4) to component plans.

(b) *Definition of a plan.* For purposes of section 401(a)(4), unless the context clearly indicates otherwise, the term "plan" means a plan as defined in §1.410(b)-7(a) and (b), after application of the mandatory disaggregation rules of §1.410(b)-7(c).

(c) *Application of section 401(a)(4) to aggregated plans—* (1) *In general.* Plans that are aggregated and treated as a single plan for purposes of the ratio or nondiscriminatory classification tests of section 410(b) must also be treated as a single plan for purposes of section 401(a)(4). Thus, a plan that is part of an aggregated plan satisfies section 401(a)(4) only if the aggregated plan does not discriminate in favor of highly compensated employees with respect to the amount of contributions or benefits and satisfies all of the other requirements of section 401(a)(4) set forth in §1.401(a)(4)-1(b) as if it were a single plan. Except as provided in paragraphs (c)(2) through (4) of this section, whether an aggregated plan satisfies section 401(a)(4) is determined using the same rules that are applicable to a single plan. Thus, for example, an aggregated plan that includes a defined benefit plan must generally be tested on the basis of both normal and most valuable benefits (or on the basis of the contributions equivalent to both the normal benefit and the most valuable benefit). See §1.410(b)-7(d) for rules governing plan aggregation for purposes of the ratio and nondiscriminatory classification tests. See §§1.401(a)(4)-2(d)(4), 1.401(k)-1(b)(5)(i), and 1.401(m)-1(b)(4)(i) for special aggregation rules applicable to plans subject to section 401(k) or 401(m) and related plans that are treated as part of the same plan for purposes of those sections.

(2) *Special rules for demonstrating nondiscrimination with respect to the amount of contributions or benefits—* (i) *Calculation of allocation rates.* An employee's normal allocation rate for a plan year under an aggregated plan is the sum of the employee's allocation rates, determined under §1.401(a)(4)-2, for the year under any defined contribution plans included in the aggregated plan and the employee's equivalent normal allocation rates, determined under §1.401(a)(4)-8, for the year under any defined benefit plans included in the aggregated plan. An employee's most valuable allocation rate under the aggregated plan is the sum of the employee's allocation rates, determined under §1.401(a)(4)-2, for the year under any defined contribution plans included in the aggregated plan and the employee's equivalent most valuable allocation rates under any defined benefit plans included in the aggregated plan, determined under §1.401(a)(4)-8.

(ii) *Calculation of benefit accrual rates—*(A) *Annual method—*(*1*) *Aggregated plans including defined contribution plans.* If the annual method is used, an employee's normal benefit accrual rate under an aggregated plan that includes one or more defined contribution plans is the sum of the employee's normal form accruals, determined under §1.401(a)(4)-8(c)(2)(i), under all defined benefit plans included in the aggregated plan, expressed as a dollar amount or as a percentage of the employee's compensation, and the employee's equivalent benefit accrual rates, determined under the annual method of §1.401(a)(4)-8(b)(2), under all defined contribution plans included in the aggregated plan, likewise expressed as a dollar amount or as a percentage of the employee's compensation. Similarly, an employee's most valuable benefit accrual rate is the sum of the employee's most valuable accruals, determined under §1.401(a)(4)-8(c)(2)(i) and (3), under all defined benefit plans included in the aggregated plan, expressed as a dollar amount or as a percentage of the employee's compensation, and the employee's equivalent benefit accrual rates, determined under §1.401(a)(4)-8(b)(2), under all defined contribution plans included in the aggregated plan, likewise expressed as a dollar amount or as a percentage of the employee's compensation.

(*2*) *Aggregated plans including no defined contribution plans.* If the annual method is used, an employee's normal and most valuable benefit accrual rates under an aggregated plan that includes no defined contribution plans are the sum of the employee's normal and most valuable benefit accrual rates, respectively, determined

under the annual method in §1.401(a)(4)-3(c)(3)(ii), under all defined benefit plans included in the aggregated plan.

(B) *Accrued-to-date method.* If the accrued-to-date method is used, an employee's normal benefit accrual rate is the sum of the employee's normal benefit accrual rates, determined under the accrued-to-date method of §1.401(a)(4)-3(c)(3)(iii), under all defined benefit plans included in the aggregated plan, and the employee's equivalent benefit accrual rates, determined under the accrued-to-date method of §1.401(a)(4)-8(b)-(3), under all defined contribution plans included in the aggregated plan. An employee's most valuable benefit accrual rate is the sum of the employee's most valuable accrual rates under all defined benefit plans included in the aggregated plan, determined under the accrued-to-date method of §1.401(a)(4)-3(c)(3)(iii), and the employee's equivalent benefit accrual rates, determined under the accrued-to-date method of §1.401(a)(4)-8(b)-(3), under all defined contribution plans included in the aggregated plan.

(C) *Projected method.* The projected method in §1.401(a)(4)-3(c)(3)(iv) may only be used if an aggregated plan contains no defined contribution plans. If this method is used, an employee's normal and most valuable benefit accrual rates are the sum of the employee's normal and most valuable benefit accrual rates, respectively, determined under the annual method in §1.401(a)(4)-3(c)(3)(iv), under all defined benefit plans in the aggregated plan.

(iii) *Defined benefit plans with uniform formulas.* The special rules in §§1.401(a)(4)-3(c)(1)(ii) and 1.401(a)-(4)-8(c)(1), relating to plans with uniform formulas, do not apply to an aggregated plan unless they apply to all defined benefit plans in the aggregated plan, and the aggregated plan contains no defined contribution plans.

(iv) *Options and consistency rules.* Except as otherwise provided in this paragraph (c), any optional methods for calculating allocation or accrual rates that would be available to a plan may be used in calculating allocation or accrual rates under an aggregated plan, provided that the optional methods selected are applied on a consistent basis to all employees under the aggregated plan. Options that may be used on a consistent basis include:

(A) The option to test a plan either on a benefits or a contributions basis;

(B) Optional bases for determining allocation or accrual rates under a plan, such as alternative normal retirement ages under §1.401(a)(4)-3 and alternative testing ages under §1.401(a)(4)-8;

(C) Actuarial assumptions; and

(D) Options to take certain amounts into account, such as the option to impute permitted disparity and the option to take the value of certain disability benefits provided under a defined benefit plan into account.

(3) *Special rules for demonstrating nondiscriminatory availability of benefits, rights, and features*—(i) *In general.* An aggregated plan that includes both one or more defined contribution plans and one or more defined benefit plans satisfies §§1.401(a)(4)-4 and 1.401(a)-4 with respect to the current availability of benefits, rights, and features that are not core benefits, rights, or features, if:

(A) Each such benefit, right, or feature that is currently available to any highly compensated employee under any defined contribution plan included in the aggregated plan is also currently available either to a group of employees that satisfies the ratio test of section 410(b)(1)(B) or the nondiscriminatory classification test of section 410(b)(2)(A)(i) (without regard to the average benefit percentage test in section 410(b)(2)(A)(ii)) or to all nonhighly compensated employees under all defined contribution plans included in the aggregated plan; and

(B) Each such benefit, right, or feature that is currently available to any highly compensated employee under any defined benefit plan included in the aggregated plan is also currently available either to a group of employees that satisfies the ratio test of section 410(b)(1)(B) or the nondiscriminatory classification test of section 410(b)(2)(A)(i) (without regard to the average benefit percentage test in section 410(b)(2)(A)(ii)) or to all nonhighly compensated employees under all defined benefit plans included in the aggregated plan.

(ii) *Core benefits, rights, and features*—(A) *In general.* For purposes of this paragraph (c)(3), core benefits, rights, and features include single sum benefits, loans, ancillary benefits as defined in §1.401(a)(4)-4(e), and benefit commencement dates (including availability of in-service withdrawals). The availability of core benefits, rights, and features under an aggregated plan must satisfy §§1.401(a)-4 and 1.401(a)(4)-4 without reliance on the special rule in paragraph (c)(3)(i) of this section.

(B) *Special rule for spousal benefits.* An aggregated plan satisfies §§1.401(a)(4)-4 and 1.401(a)-4 with respect to the availability of any nonsubsidized qualified joint and survivor annuities, qualified preretirement survivor annuities, or spousal death benefits described in section 401(a)(11), if each plan that is part of the aggregated plan satisfies section 401(a)(11). If any subsidized benefits are provided, the availability of the subsidized benefits under the aggregated plan must be tested under paragraph (c)(3)(i) or (ii)(A) of this section, whichever is applicable. For purposes of this paragraph (c)(3)(ii)-(B), a qualified joint and survivor annuity, a qualified preretirement survivor annuity, or a spousal death benefit is deemed to be nonsubsidized if it is provided under a defined contribution plan.

(4) *Special rule relating to employee contributions.* If an aggregated plan includes a defined benefit plan that contains employee contributions that are not allocated to separate accounts, the amount of employer-derived benefits must be determined under the general rule in §1.401(a)(4)-6(b)(1).

(d) *Plan restructuring*—(1) *In general.* A plan or aggregated plan may be treated, in accordance with this paragraph (d), as consisting of two or more component plans for purposes of determining whether the plan or aggregated plan satisfies section 401(a)(4). If each of the component plans of a plan or aggregated plan satisfies all of the requirements of sections 401(a)(4) and 410(b) as if it were a separate plan or aggregated plan, then the plan or aggregated plan is treated as satisfying section 401(a)(4).

(2) *Identification of component plans*—(i) *Permissible bases for restructuring.* A plan or aggregated plan may be restructured into compo-

nent plans only by using the following methods:

(A) *Employee groups.* A plan or aggregated plan (including a plan subject to section 401(k) or (m)) may be restructured into component plans, each consisting of all of the allocations, accruals and other benefits, rights, and features provided to a group of employees under the plan or aggregated plan. Each employee is permitted to be included in only one such component plan.

(B) *Total rates.* A plan or aggregated plan (other than a plan subject to section 401(k) or (m)) may be restructured into component plans, each consisting of normal accrual or allocation rates equal to a different specified rate (or within a different specified range), and all benefits, rights and features provided under the plan or aggregated plan to employees having normal accrual or allocation rates equal to the specified rate (or within the specified range). An employee is permitted to be included in only one such component plan. A component plan consisting of rates equal to a specified rate (or within a specified range) must include all the rates equal to the specified rate (or all rates within the specified range) under the plan or aggregated plan. Thus, for example, a plan benefiting employees A and B, both of whom have 1 percent accrual rates, may not be restructured under this method into one component plan containing A's 1 percent rate and another containing B's 1 percent rate.

(C) *Rate segments.* A plan or aggregated plan (other than a plan subject to section 401(k) or (m)) may be restructured into component plans, each consisting of a different incremental segment of employees' normal accrual or allocation rates, and all associated benefits, rights, and features. An employee is permitted to be included in more than one such component plan, but only with respect to different incremental segments of his total rate under the plan or aggregated plan. Thus, an incremental segment of accrual rates could consist of the incremental benefits provided by that part of the accrual rate that lies between 2 and 4 percent of compensation. Incremental segments are not permitted to overlap, and a component plan consisting of a specified incremental segment of employees' accrual or allocation rates must include this segment of all employees' rates. Thus, for example, a plan under which employees A, B, and C have accrual rates of 1, 1 and 2 percent, respectively, may not be restructured under this method into one component plan containing A's 1 percent rate and the first 1 percent of C's rate, and another plan containing B's 1 percent rate and the remaining 1 percent of C's rate.

(D) *Residual parts.* Any residual parts of a plan or aggregated plan remaining after restructuring under one of the three methods provided above are also treated as a component plan.

(ii) *Consistency rules.* A plan or aggregated plan may use only the employee group, the total rate or the rate segment method for any one plan year. In addition, a portion of a plan that is treated as part of one component plan for a plan year may not be treated as part of another component plan for the same plan year.

(iii) *Application of grouping rules.* If the grouping rules in §§1.401(a)(4)-2(c)(5) or 1.401(a)(4)-3(c)(3)(v) are used in combination with the employee group method in paragraph (d)(2)(i)(A) of this section, the grouping rules are permitted to be applied only after restructuring. If the grouping rules are used in combination with the total rate or rate segment methods in paragraphs (d)(2)(i)(B) or (d)(2)(i)(C) of this section, the grouping rules are permitted to be applied only before restructuring.

(iv) *Application of uniformity requirement for definitions of compensation.* The uniformity requirement applicable to a definition of compensation under §1.401(a)(4)-12(a) and to a compensation formula under §1.401(a)(4)-3(f)(2)(i)(B) is applied only after restructuring in the case of a plan or aggregated plan that uses the employee group method of paragraph (d)(2)(i)(A) of this section, and only before restructuring in the case of a plan or aggregated plan that uses the total rate or rate segment method of paragraph (d)(2)(i)(B) or (C) of this section. The same rule applies for purposes of the consistency rule of §1.414(s)-1T(b).

(v) *Examples.* The rules of this paragraph (d)(2) are illustrated by the following examples:

Example 1. Company B maintains a defined benefit plan. The plan provides retirement benefits equal to 1 percent of final average compensation times years of service for employees at Plant X and 1.5 percent of final average compensation times years of service for employees at Plant Y. The plan may be treated as consisting of two component defined benefit plans, one providing retirement benefits equal to 1 percent of final average compensation times years of service to the employees at Plant X and another providing benefits equal to 1.5 percent of final average compensation times years of service to employees at Plant Y. Alternatively, the plan could be treated as consisting of two component defined benefit plans, one providing retirement benefits equal to 1 percent of final average compensation to employees at Plants X and Y, and another providing benefits equal to 0.5 percent of final average compensation to employees at Plant Y. If both component plans satisfy sections 410(b) and 401(a)(4), then the entire plan satisfies section 401(a)(4).

Example 2. Assume the same facts as in Example 1, except that Company B also maintains another defined benefit plan providing retirement benefits equal to 2 percent of career average compensation times years of service for employees at Plant Z. The plan covering employees at Plants X and Y could be aggregated with the plan covering employees at Plant Z under section 410(b), and the aggregated plan could then be restructured into component plans. For example, the aggregated plan could be treated as consisting of two plans, one providing retirement benefits equal to 1 percent of final average compensation times years of service to employees at Plant X and benefits equal to 2 percent of career average compensation times years of service at Plant Z, and another providing benefits equal to 1.5 percent of final average compensation to employees at Plant Y. If both component plans satisfy sections 410(b) and 401(a)(4), then the entire aggregated plan satisfies section 401(a)(4).

Example 3. Company C maintains a defined contribution plan for its employees A, B, C, D, E, and F. The employees have allocation rates of 6.9, 7, 7.1, 9.9, 10, and 10.1 percent respectively. Assume that the six allocation rates may be grouped into two allocation rates of 7 and 10 percent using the rules in §1.401(a)(4)-2(c)(5). The plan can be restructured into two component plans, one providing an allocation rate of 7 percent to employees A, B, and C and another providing an allocation rate of 10 percent to employees D, E, and F. Alternatively, the plan could be treated as consisting of one component plan providing an allocation rate of 7 percent to all employees and another providing an allocation rate of 3 percent to employees D, E, and F. If both component plans satisfy sections 410(b) and 401(a)(4), then the entire plan satisfies section 401(a)(4).

(3) *Satisfaction of section 401(a)(4) by a component plan.* The rules applicable in determining whether a component plan satisfies section 401(a)(4) are the same as those applicable to a plan or aggregated plan, except as provided in paragraph (d)(2) of this section. Thus, for example, in the case of a defined benefit plan, the

normal and most valuable benefits tested under §1.401(a)(4)-3 must be separately identified with respect to each component plan. Similarly, a component plan that consists of a uniform formula under a defined benefit plan may be tested under the safe harbor tests of §1.401(a)(4)-3(b) even if the other component plans are tested under the general test of §1.401(a)(4)-3(c). Further, if a component plan includes portions of two plans, the special rules for aggregated plans in paragraph (c) of this section must be satisfied.

(4) *Satisfaction of section 410(b) by a component plan*—(i) *In general.* The rules applicable in determining whether a component plan satisfies section 410(b) are generally the same as those applicable to a plan or aggregated plan. Thus, for example, the mandatory aggregation rules of §1.410(b)-7(e) are applicable in determining whether a component plan satisfies the average benefit percentage test. However, the following special rules apply to component plans. First, the permissive aggregation rules of §1.410(b)-7(d) are not available. Second, a component plan identified using the total rate or rate segment method in paragraph (d)(2)(i)(B) or (C) of this section is deemed to satisfy the reasonableness standard of §1.410(b)-4(b).

(ii) *Relationship to satisfaction of section 410(b) by plan or aggregated plan.* Satisfaction of section 410(b) by component plans is relevant solely for purposes of determining whether a plan or aggregated plan that is tested on the basis of its component plans satisfies section 401(a)(4). The plan or aggregated plan must still independently satisfy section 410(b) in order to be a qualified plan.

(5) *Relationship to other restructuring rules.* The rules in this paragraph (d) are applied prior to the restructuring rules in Q&A-2(b)(4) of §1.401(a)-4. Thus, the restructuring rules in that section may be applied further to divide a component plan into distinct units based on different benefits, rights, and features in determining whether the component plan satisfies §§1.401(a)-4 and 1.401(a)(4)-4.

(6) *Effect of restructuring under other sections.* The restructuring rules provided in this paragraph (d) apply solely for purposes of section 401(a)(4). Thus, for example, a component plan is not treated as a separate plan under section 401(a)(26).

§1.401(a)(4)-10 Testing of former employees.

(a) *In general.* The requirements of section 401(a)(4) with respect to the amount of contributions and benefits and the availability of benefits, rights, and features under a plan apply separately to employees and former employees. This section contains rules for applying those requirements to former employees. Rules for determining whether a plan satisfies section 401(a)(4) with respect to the amount of contributions or benefits and the availability of benefits, rights, and features provided to former employees under the plan are set forth in paragraphs (b) and (c) of this section respectively.

(b) *Amounts of contributions or benefits*—(1) *Plans benefiting no former employees.* A plan under which no former employee currently benefits satisfies section 401(a)(4) with respect to the amount of contributions or benefits provided to former employees.

(2) *Plans benefiting former employees*—(i) *General rule.* A plan under which one or more former employees currently benefit satisfies section 401(a)(4) with respect to the amount of contributions or benefits provided to former employees if it satisfies §1.401(a)(4)-1(b)(2) with respect to these contributions or benefits. If a plan is amended to increase benefits for former employees (for example, to provide an ad hoc cost-of-living adjustment), it is treated as currently benefiting the former employees affected by the amendment in the year the amendment first becomes effective.

(ii) *Special rule.* A plan satisfies section 401(a)(4) with respect to the amount of benefits provided to former employees if the formula under which the benefits are provided does not by its terms favor highly compensated employees or highly compensated former employees, the benefit is currently provided to at least 5 former employees, and at least 60 percent of the former employees to whom the benefit is currently provided are not highly compensated former employees.

(iii) *Proportional cost-of-living increases.* A defined benefit plan satisfies section 401(a)(4) with respect to the amount of any ad hoc cost-of-living adjustments provided to former employees if the adjustments increase, on a uniform and consistent basis, the benefits of former employees in reasonable proportion to increases in the cost of living that occurred after these employees retired at or after normal retirement age or commenced receipt of benefits, or after a later date specified in the amendment granting the adjustments.

(c) *Availability of benefits, rights, or features*—(1) *Plans benefiting no former employees.* A plan under which no former employee currently benefits satisfies section 401(a)(4) with respect to the availability of benefits, rights, and features provided to former employees if the plan satisfies §§1.401(a)-4 and 1.401(a)(4)-4 with respect to these benefits, rights, or features. Alternatively, the plan satisfies section 401(a)(4) with respect to the availability of benefits, rights, and features provided to the former employees if no changes in the availability of any benefits, rights, or features available to any former employee are made after the employee becomes a former employee, or if any changes in the availability of any benefits, rights, or features provided to any highly compensated former employee in plan years beginning after December 31, 1988, are applied on a consistent basis to all other employees and former employees under the plan.

(2) *Plans benefiting former employees*—(i) *General rule.* A plan under which one or more former employees currently benefit satisfies section 401(a)(4) with respect to the availability of benefits, rights, and features provided to former employees if it satisfies §§1.401(a)-4 and 1.401(a)(4)-4 with respect to these benefits, rights, or features.

(ii) *Special rule.* A plan satisfies section 401(a)(4) with respect to the availability of benefits, rights, or features provided to former employees if the availability of these benefits, rights, or features does not by its terms favor former highly compensated employees, the benefits, rights, or features are currently provided to at least 5 former employees, and at least 60 percent of the former employees to

whom the benefits, rights, or features are currently provided are not highly compensated former employees.

(iii) *Plan loans.* For purposes of demonstrating that a plan satisfies section 401(a)(4) with respect to the availability of loans provided to former employees, an employer may treat as employees those former employees who are parties in interest within the meaning of section 3(14) of the Employee Retirement Income Security Act of 1974.

§1.401(a)(4)–11 Special Rules.

(a) *In general.* This section contains special rules for determining whether a plan satisfies section 401(a)(4). Paragraph (b) of this section contains rules for the treatment of the portion of an employee's accrued benefit or account balance that is attributable to rollovers and transfers between plans. Paragraph (c) contains rules relating to vesting.

(b) *Rollovers and transfers*—(1) *Rollovers and elective transfers.* The portion of an employee's accrued benefit or account balance that is attributable to rollover contributions described in section 402(a)(5) and 403(a)(4) or to elective transfers described in §1.411(d)–4, Q&A–3(b), are not taken into account in determining whether the transferee plan satisfies §1.401(a)(4)–1(b)(2).

(2) *Other transfers.* [Reserved].

(c) *Vesting*—(1) *In general.* A plan, including an aggregated plan or component plan treated as a single plan under §1.401(a)(4)–9, does not satisfy the nondiscriminatory amount requirement of §1.401(a)(4)–1(b)(2) if the manner in which employees vest in their accrued benefits discriminates in favor of highly compensated employees. This determination is made after taking into account any relevant provisions of sections 401(a)(5)(E), 411(d)(1), 411(d)(2), and 411(e).

(2) *Deemed equivalence of statutory vesting schedules.* For purposes of this paragraph (c), when two or more plans with different vesting schedules are treated as a single plan for purposes of sections 410(b) and 401(a)(4), the minimum vesting rates required under the vesting schedules described in section 411(a)(2)(A) and (B) are treated as equivalent to one another, and the minimum vesting rates required under the vesting schedules described in section 416(b)(1)(A) and (B) are treated as equivalent to one another. Thus, for example, Plan A, covering an employer's nonhighly compensated employees and providing full vesting after completion of 5 years of service and Plan B, covering the same employer's highly compensated employees and providing vesting according to the schedule provided in section 411(a)(2)(B), do not fail to satisfy section 401(a)(4) when treated as a single plan merely because of this difference in vesting schedules.

(d) *Family aggregation rules.* [Reserved].

§1.401(a)(4)–12 Definitions.

The following definitions apply for purposes of section 401(a)(4) and the regulations thereunder unless the context clearly indicates otherwise:

(a) *Compensation.* "Compensation" means compensation determined under a definition of compensation that satisfies the requirements of section 414(s) and the regulations thereunder and that is uniform for all employees under the plan, aggregated plan or component plan being tested. The applicable plan year under section 414(s) for purposes of applying section 401(a)(4) and the regulations thereunder is the plan year for which a determination is being made. Section 401(a)(17) and the regulations thereunder contain additional limitations on the amount of compensation that may be taken into account with respect to any employee for a plan year.

(b) *Covered by a collective bargaining agreement.* "Covered by a collective bargaining agreement" means covered by a collective bargaining agreement within the meaning of §1.410(b)–6(d) and (e).

(c) *Currently benefiting.* "Currently benefiting" means benefiting within the meaning of §1.410(b)–3, without regard to paragraphs (b)(2)(iv) and (v) thereof.

(d) *Defined benefit plan.* "Defined benefit plan" means a defined benefit plan within the meaning of section 414(j).

(e) *Defined contribution plan.* "Defined contribution plan" means a defined contribution plan within the meaning of section 414(i).

(f) *Employee.* "Employee" means an active employee, as defined in §1.410(b)–9(a)(1), who is currently benefiting under the plan, aggregated plan, or component plan being tested.

(g) *Employer.* "Employer" means an employer as defined in §1.410(b)–9(b).

(h) *ESOP.* "ESOP" means an employee stock ownership plan that meets the requirements of section 4975(e)(7) and the regulations thereunder.

(i) *Former employee.* "Former employee" means a former employee as defined in §1.410(b)–9(a).

(j) *Highly compensated employee.* "Highly compensated employee" means an employee who is a highly compensated employee as defined in section 414(q).

(k) *Highly compensated former employee.* "Highly compensated former employee" means a highly compensated former employee as defined in section 414(q)(9).

(l) *Multiemployer plan.* "Multiemployer plan" means a multiemployer plan within the meaning of section 414(f).

(m) *Nonhighly compensated employee.* "Nonhighly compensated employee" means an employee who is not a highly compensated employee.

(n) *Nonhighly compensated former employee.* "Nonhighly compensated former employee" means a former employee who is not a highly compensated former employee.

(o) *Professional.* "Professional" means a professional as defined in §1.410(b)–9(g).

(p) *Qualified plan.* "Qualified plan" means a plan that satisfies the requirements of section 401(a). A qualified plan includes an annuity plan described in section 404(a)(2).

(q) *Year of service.* "Year of service" means a year of service as defined in section 411(a)(5) that is taken into account for purposes of benefit accrual or in determining allocations under the plan. The term includes a 1-year period of service under the elapsed time method of §1.410(a)–7. An employee may be treated as credited with no more than 1 year of service with respect to any 12 consecutive month period, except for those cases in which additional service is required to be credited under section 410 or 411.

§1.401(a)(4)–13 Effective dates.

(a) *In general.* Sections

1.401(a)(4)-1 through 1.401(a)(4)-13 apply to plan years beginning on or after January 1, 1991. For plan years beginning before that date and on or after the first day of the first plan year to which the amendments made to section 410(b) by section 1112(a) of the Tax Reform Act of 1986 apply, a plan must be operated in accordance with a reasonable, good faith interpretation of section 401(a)(4). Whether a plan is operated in accordance with a reasonable, good faith interpretation of section 401(a)(4) will generally be determined on the basis of all relevant facts and circumstances, including the extent to which an employer has resolved unclear issues in its favor. A plan will be deemed to be operated in accordance with a reasonable, good faith interpretation of section 401(a)(4) if it is operated in accordance with the terms of §§1.401(a)(4)-1 through 1.401(a)(4)-13.

(b) *Transitional rule for governmental plans.* Section 401(a)(4) is considered satisfied for plan years beginning before January 1, 1993, in the case of governmental plans described in section 414(d).

Par. 4. Section 1.401(a)(5)-1 as proposed on November 15, 1988 (53 FR 45917), is amended by:

1. Removing reserved paragraphs (a), (b), and (f),

2. Redesignating paragraphs (c), (d), and (e) as paragraphs (d), (e), and (f), and

3. Adding new paragraphs (a), (b), and (c). These added paragraphs and the heading of the redesignated paragraphs read as follows:

§1.401(a)(5)-1 Special rules relating to nondiscrimination requirements.

(a) *In general.* Section 401(a)(5) sets out certain provisions that will not of themselves be discriminatory within the meaning of section 410(b)(2)(A)(i) or section 401(a)(4). The exceptions specified in section 401(a)(5) are not an exclusive enumeration, but are merely a recital of provisions frequently encountered that will not of themselves constitute prohibited discrimination in contributions or benefits. See section 401(a)(4) and the regulations thereunder for the basic nondiscrimination rules. See §1.410(b)-4 for the rule of section 410(b)(2)(A)(i) (relating to the nondiscriminatory classification test that is part of the minimum coverage requirements) referred to in section 401(a)(5)(A). See paragraphs (b) through (f) of this section for special rules used in applying the section 401(a)(4) nondiscrimination requirements under the remaining provisions of section 401(a)(5).

(b) *Salaried or clerical employees.* A plan does not fail to satisfy the nondiscrimination requirements of section 401(a)(4) merely because contributions or benefits provided under the plan are limited to salaried or clerical employees.

(c) *Uniform relationship to compensation.* A plan does not fail to satisfy the nondiscrimination requirements of section 401(a)(4) merely because the contributions or benefits of, or on behalf of, the employees under the plan bear a uniform relationship to the compensation (within the meaning of section 414(s) and the regulations thereunder) of those employees.

(d) *Certain disparity permitted.* * * *

(e) *Defined benefit plans integrated with social security.* * * *

(f) *Certain benefits not taken into account.* * * *

Par. 5. Section 1.410(b)-5 as proposed on May 18, 1989 (54 FR 21437), is amended by adding the text of paragraph (d) and paragraph (e) to read as follows:

§1.410(b)-5 Average benefit percentage test.

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(d) *Calculation of employee benefit percentages*—(1) *In general.* This paragraph (d) provides rules for calculating employee benefit percentages. These rules are generally the same as the rules used for calculating allocation and accrual rates under an aggregated plan under section 401(a)(4), except that elective and matching contributions subject to section 401(k) and (m) are taken into account. Since the average benefit percentage test applies only to employer-derived benefits, employee contributions (including employee contributions subject to section 401(m)) and benefits attributable to employee contributions are not taken into account in calculating employee benefit percentages. The amount of benefits attributable to employee contributions not allocated to separate accounts is calculated under §1.401(a)(4)-6(b), including any applicable safe harbor methods provided in that section. Paragraph (e) of this section contains additional optional rules for calculating employee benefit percentages.

(2) *Plans and plan years taken into account*—(i) *Testing group.* Except as provided in paragraph (e)(2) of this section, all plans and portions of plans treated as a single plan under §1.410(b)-7(e), and only those plans and portions of plans, are taken into account in calculating an employee's employee benefit percentage. This group of plans and portions of plans is referred to in this section as the "testing group."

(ii) *Testing period.* Except as provided in paragraph (e)(8) of this section, an employee's employee benefit percentage is calculated on the basis of the plan years specified in §1.410(b)-8(b)(4). These plan years are referred to in this section as the "relevant plan years" or, in the aggregate, as the "testing period."

(3) *Contributions or benefits basis.* Employee benefit percentages may be calculated either on a contributions or a benefits basis. Except as provided in paragraph (e)(2) of this section, employee benefit percentages for any testing period must be calculated on the same basis (contributions or benefits) for all plans or portions of plans in the testing group. Paragraphs (d)(4) and (d)(5) of this section set forth the general rules for calculating an employee's employee benefit percentage on a contributions or a benefits basis, respectively. These rules generally require an employer to add up an employee's normal benefit accrual rates and allocation rates under any plans in the testing group to which the permitted disparity rules of section 401(l) are available. They then allow this sum to be adjusted by imputing permitted disparity. Finally, they require this amount to be increased by the employee's normal benefit accrual and allocation rates under any plans in the testing group to which the permitted disparity rules of section 401(l) are not available (for example, the portion of a plan subject to section 401(k)). Paragraph (d)(6) of this section sets forth an additional rule directing that an em-

ployee's most valuable accruals, rather than normal form accruals, be taken into account under some circumstances.

(4) *Calculation on a contributions basis.* If employee benefit percentages for a testing group are calculated on a contributions basis for a testing period, each employee's employee benefit percentage is calculated according to the following steps:

(i) Calculate the allocations taken into account with respect to the employee under §1.401(a)(4)-2(c) for the relevant plan year for each defined contribution plan or portion of a plan to which the permitted disparity rules of section 401(l) are available.

(ii) Calculate the employee's normal form accrual as defined in §1.401(a)(4)-8(c)(2)(i) for the relevant plan year under each defined benefit plan or portion of a plan to which the permitted disparity rules of section 401(l) are available, and then convert these accruals into equivalent allocations using the method prescribed in §1.401(a)(4)-8(c)(2)(ii). Accruals attributable to a plan provision, including an amendment, that provides past service credit must be taken into account for this purpose in the year the provision is effective if the provision has the effect of discriminating significantly in favor of highly compensated employees. The determination of whether such a provision causes significant discrimination is made by applying the principles of §1.401(a)(4)-5(b) to all employees under all plans and portions of plans in the testing group.

(iii) Add the allocations and equivalent allocations calculated in steps (i) and (ii), and divide the total by the employee's compensation, as defined in §1.410(b)-9(c), for any one of the relevant plan years in the testing period (provided it is not a short year), or for the calendar year beginning and ending with or within such years. Except as provided in paragraph (e)(8) of this section, the same definition of compensation must be used to calculate all employee benefit percentages under all plans or portions of plans in the testing group for a testing period. It is not necessary, however, that the same definition of compensation be used for different testing periods.

(iv) Adjust the amount determined in step (iii) by imputing permitted disparity using the method in §1.401(a)(4)-7(b). This adjustment is permitted, but not required. If it is made with respect to any nonhighly compensated employee's employee benefit percentage under the testing group for a testing period, however, it must be made with respect to all highly compensated employees' employee benefit percentages under the testing group for the testing period. The compensation determined under step (iii) must be used in imputing permitted disparity for this purpose, without regard to §1.401(a)(4)-7(d)(5).

(v) Add the employee's allocations and equivalent allocations for the relevant plan year under any defined contribution or defined benefit plans or portions of plans to which the permitted disparity rules of section 401(l) are not available, using the rules in steps (i) and (ii), and divide the total by the employee's compensation used in step (iii).

(vi) Add the rate determined in step (v) to the rate determined in step (iv). This is the employee's employee benefit percentage for the testing period with respect to the testing group.

(5) *Calculation on a benefits basis.* If employee benefit percentages for a testing group are calculated on a benefits basis for a testing period, each employee's employee benefit percentage is calculated according to the following steps:

(i) Calculate the employee's normal form accrual as defined in §1.401(a)(4)-8(c)(2)(i) for the relevant plan year under each defined benefit plan or portion of a plan to which the permitted disparity rules of section 401(l) are available. In applying §1.401(a)(4)-8(c)(2)(i), a uniform normal retirement age must be used for all employees. Accruals attributable to a plan provision, including an amendment, that provides past service credit must be taken into account for this purpose in the year the provision is effective if the provision has the effect of discriminating significantly in favor of highly compensated employees. The determination of whether such a provision causes significant discrimination is made by applying the principles of §1.401(a)(4)-5(b) to all employees under all plans and portions of plans in the testing group.

(ii) Calculate the allocations taken into account with respect to the employee under §1.401(a)(4)-2(c) for the relevant plan year, for each defined contribution plan or portion of a plan to which the permitted disparity rules of section 401(l) are available, and convert these allocations into equivalent accruals using the method prescribed in §1.401(a)(4)-8(b)(2)(ii). In applying §1.401(a)(4)-8(b)(2)(ii), the testing age used must be the uniform normal retirement age used in step (i).

(iii) Add the accruals and equivalent accruals calculated in steps (i) and (ii), and divide the total by the employee's compensation, as defined in §1.410(b)-9(c), for any one of the relevant plan years in the testing period (provided it is not a short year), or for the calendar year beginning and ending with or within such years. Except as provided in paragraph (e)(8) of this section, the same definition of compensation must be used to calculate all employee benefit percentages under all plans or portions of plans in the testing group for a testing period. It is not necessary, however, that the same definition of compensation be used for different testing periods.

(iv) Adjust the amount determined in step (iii) by imputing permitted disparity using the annual method in §1.401(a)(4)-7(c)(5)(ii). This adjustment is permitted, but not required. If it is made with respect to any nonhighly compensated employee's employee benefit percentage under the testing group for a testing period, however, it must be made with respect to all highly compensated employees' employee benefit percentages under the testing group for the testing period. The compensation determined under step (iii) must be used in imputing permitted disparity for this purpose, without regard to §1.401(a)(4)-7(d)(5).

(v) Add the employee's accruals and equivalent accruals for the relevant plan year under any defined benefit or defined contribution plans or portions of plans to which the permitted disparity rules of section 401(l) are not available, using the rules in steps (i) and (ii), and divide the total by the employee's compensation used in step (iii).

(vi) Add the rate determined in step (v) to the rate determined in step (iv). This is the employee's employee benefit percentage for the testing period with respect to the testing group.

(6) *Requirements for certain plans providing early retirement benefits*—(i) *General rule.* If a defined benefit plan or portion of a plan provides early retirement benefits in addition to normal retirement benefits to any highly compensated employee, and the average actuarial reduction for any of these benefits commencing in the 5 years prior to the plan's normal retirement age is less than 4 percent per year, then employee benefit percentages under the testing group must be computed under paragraphs (d)(4) and (d)(5) of this section on the basis of employees' most valuable accruals and allocations rather than normal form accruals and allocations. For this purpose, an employee's most valuable accrual is determined in a manner consistent with the rules in §1.401(a)(4)–8(c)(3), using the same benefit commencement date for all employees.

(ii) *Exception.* Paragraph (d)(6)(i) of this section does not apply if early retirement benefits with average actuarial reductions described in that paragraph are currently available, within the meaning of §§1.401(a)–4 and 1.401(a)(4)–4, under plans or portions of plans in the testing group to a percentage of nonexcludable nonhighly compensated employees that is at least 70 percent of the percentage of nonexcludable highly compensated employees to whom these benefits are currently available.

(e) *Additional optional rules*—(1) *Overview.* This paragraph (e) contains various optional rules that may be used, alone or in combination, by an employer in calculating employee benefit percentages for a testing period. If any of these rules is used for a testing period, it must be applied, to the extent possible, on a uniform and consistent basis in calculating employee benefit percentages under all plans or portions of plans in the testing group for that period.

(2) *Calculation of employee benefit percentages without regard to plans of a different type*—(i) *General rule.* An employer may determine employee benefit percentages under plans of one type (i.e., defined benefit or defined contribution plans) without regard to plans of a different type (i.e., defined contribution or defined benefit plans, respectively), using the method provided in this paragraph (e)(2). If this method is used to determine whether a defined benefit plan satisfies the average benefit percentage test, employee benefit percentages under all defined benefit plans in the testing group must be calculated on a benefits basis, and all allocations under any defined contribution plans in the same testing group must be disregarded (i.e., treated as zero). Thus, for example, if all of the defined contribution plans in a testing group satisfy the ratio test of section 410(b)(1)(B), these plans are not only not required to satisfy the average benefit percentage test, but may also be disregarded in determining whether any defined benefit plans in the testing group satisfy the average benefit percentage test. If this method is used to determine whether a defined contribution plan satisfies the average benefit percentage test, employee benefit percentages under all defined contribution plans in the testing group must be calculated on a contributions basis, and all benefits under any defined benefit plans in the same testing group must be disregarded (i.e., treated as zero). Employees may not be treated as excludable employees solely because they are deemed to receive no benefit accrual or allocation under a plan under this optional method. This optional method may not be used if any of the plans in the testing group relies on any of the conversion methods provided in §1.401(a)(4)–8 to satisfy section 401(a)(4).

(ii) *Effect of use of method.* A plan does not satisfy the average benefit percentage test using the method provided in this paragraph (e)(2) unless each of the plans of the employer of a different type (i.e., defined benefit or defined contribution) than the plan being tested satisfies section 410(b) using this method or the ratio test of section 410(b)(1)(B).

(iii) *Treatment of permitted disparity*—(A) *Plans of both types using method.* If the method provided in this paragraph (e)(2) is used to determine whether one or more defined benefit plans and one or more defined contribution plans in a testing group satisfy the average benefit percentage test, permitted disparity may generally be taken into account, to the extent permitted under this section, in determining employee benefit percentages with respect to both the group of defined benefit plans in the testing group and the group of defined contribution plans in the testing group. If any employee currently benefits under both a defined benefit and a defined contribution plan in the testing group, however, permitted disparity may be taken into account only with respect to the group of defined benefit plans in the testing group, or with respect to the group of defined contribution plans in the testing group, but not both.

(B) *Plans of only one type using method.* If the method in this paragraph (e)(2) is used to determine whether one or more defined benefit plans or one or more defined contribution plans in a testing group, but not plans of both types, satisfy the average benefit percentage test (for example, where one group of plans satisfies the ratio test of section 410(b)(1)(B)), permitted disparity may be taken into account in determining employee benefit percentages under the group of plans subject to the average benefit percentage test only for those employees with respect to whom permitted disparity is not imputed, or otherwise taken into account, in testing any plans in the other group for discrimination under section 401(a)(4).

(iv) *Consistency rules.* If the method in this paragraph (e)(2) is used, any rules in this section requiring consistency or uniformity in the application of an option or method in calculating employee benefit percentages under a testing group are satisfied if the options or methods are applied uniformly or consistently with respect to the group of defined benefit plans and defined contribution plans, respectively, in the testing group.

(v) *Example.* The method provided in this paragraph (e)(2) is illustrated in the following example:

Example. Employer A maintains two defined benefit plans, neither of which covers a group of employees that satisfies the ratio test of section 410(b)(1)(B), and a profit-sharing plan and a plan subject to section 401(k), both of which cover groups of employees satisfying section 410(b)(1)(B). The defined benefit plans will satisfy the average benefit percentage test if the ratio of the actual benefit percentages of all nonexcludable nonhighly compensated employees, computed on a benefits basis without regard to contributions under the profit-sharing plan or 401(k) plan, is at least 70 percent of the actual benefit percentage of all nonexcludable highly compensated employees, computed on a benefits basis without regard to contributions under the profit-sharing plan or 401(k) plan.

(3) *Accrued-to-date method*—(i) *General rule.* An employer may use the accrued-to-date method to calculate an employee's employee benefit percentage under paragraph (d)(5) of this section. If this method is used, the employee's relevant benefit used for purposes of §1.401(a)(4)-3(c)(3)-(iii) (i.e., the employee's total normal retirement benefit or, if paragraph (d)(6) is applicable, most valuable benefit, expressed as an annuity beginning at the same age pursuant to §1.401(a)(4)-3(c)(2)), divided by the greater of the employee's years of participation under the plan or years of credited service, is substituted for the accrual used in paragraph (d)(5)(i) and (v) of this section. Also, the employee's adjusted account balance, as defined in §1.401(a)(4)-8(b)(3)(ii), divided by the employee's years of participation in the plan, is substituted for the allocations used in paragraph (d)(5)(ii) and (v) of this section.

(ii) *Treatment of permitted disparity.* If the accrued-to-date method provided in this paragraph (e)(3) is used, disparity may only be imputed using the accrued-to-date method in §1.401(a)(4)-7(c)(5)(iii). In imputing permitted disparity for this purpose, the compensation determined under paragraph (d)(5)(iii) of this section must be used.

(iii) *Special rule for past service credit.* Years of service credited under a plan provision, including an amendment, granting past service credit may not be taken into account in applying the accrued-to-date method provided in this paragraph (e)(3) if the provision has the effect of discriminating significantly in favor of highly compensated employees. Thus, if a provision granting past service causes significant discrimination, any additional benefits or allocations resulting from the grant are taken into account, but the additional service is not. Whether such a provision causes significant discrimination is determined under the principles described in paragraph (d)(4)(ii) of this section.

(iv) *Uniform service or participation assumption.* If the average actual years of credited service or plan participation for the nonhighly compensated employees taken into account for testing purposes is no greater than the average actual years of credited service or plan participation for highly compensated employees taken into account for testing purposes, an employer may assume that all employees under a testing group have the same number of years of credited service or plan participation for purposes of dividing an employee's relevant benefit or adjusted account balance by credited service or participation in paragraph (e)(3)(i) of this section.

(4) *Alternative method for calculating employee benefit percentages for certain defined benefit plans.* For purposes of paragraph (d)(5)(i) and (v) of this section, an employer may calculate an employee's normal form accrual (or most valuable accrual, if paragraph (d)(6) of this section is applicable) under a defined benefit plan by multiplying the employee's relevant normal or most valuable accrual rate determined under §1.401(a)-(4)-3(c)(3)(ii) by the employee's compensation used in paragraph (d)(5)(iii) of this section. This method may not be used unless:

(i) The only plans included in the testing group are defined benefit plans (or the method is applied to defined benefit plans tested under the method in paragraph (e)(2) of this section), and employee benefit percentages under these defined benefit plans are calculated on a benefits basis.

(ii) Relevant normal or most valuable accrual rates are determined based on benefits commencing at a uniform or the same age for all employees.

(iii) If an employee's relevant normal or most valuable accrual rate is determined under §1.401(a)(4)-3(c)-(3)(ii) using a compensation formula, the compensation formula is also used, subject to the requirements of paragraph (e)(8) of this section, to determine compensation for purposes of paragraph (d)(5)(iii) of this section.

(5) *Alternative method for converting benefits to contributions.* If paragraph (d)(6) of this section is applicable, an employer may convert an employee's most valuable accruals under a defined benefit plan for a relevant plan year into equivalent most valuable allocations for purposes of paragraph (d)(4)(ii) and (v) of this section using the method used by the employer for determining any increase in current liabilities (as defined in section 412(l)(7)) that are attributable to the employee for the year. For this purpose, current liabilities may include amounts attributable to projected accruals for the relevant plan year for which the determination of current liabilities is being made, if the projections are made on a reasonable basis applied consistently from year to year. Thus, for example, an employer may treat any increase in current liability attributable to an employee under a plan from one relevant plan year to the next as the employee's equivalent most valuable allocation for the second year.

(6) *Imputation of permitted disparity*—(i) *Use of excess rates.* An employee's excess benefit percentage under a defined benefit excess plan, or positive rate under a defined benefit offset plan, multiplied by the employee's compensation used under the plan in determining benefit accruals, may be substituted for the amount determined under paragraph (d)(5)(i) of this section as provided in this paragraph (e)(6). Excess benefit percentages, excess benefit plans, and offset plans are defined in §1.401(l)-1(b). An employee's positive rate is the rate at which benefits would accrue under an offset plan without regard to the offset. This method may not be used unless:

(A) The only plans included in the testing group are defined benefit plans (or the method is applied to defined benefit plans tested under the method in paragraph (e)(2) of this section, and those plans are allowed to impute permitted disparity under that paragraph), and employee benefit percentages under these defined benefit plans are calculated on a benefits basis.

(B) Employee benefit percentages under the plans in the testing group are not required to be calculated on the basis of most valuable benefits under paragraph (d)(6) of this section.

(C) The excess plan or offset plan satisfies section 401(l).

(D) The excess plan or offset plan covers a group of employees that satisfies the ratio test of section 410(b)(1)(B), and either provides benefits under the same uniform formula for all employees under the plan, or provides benefits under different uniform formulas, each of which benefits a group of employees that satis-

fies the ratio test of section 410(b)(1)(B). A formula will be treated as uniform for this purpose if it satisfies §1.401(a)(4)-3(b)(2) or (b)(3) (without regard to any requirements relating to early retirement benefits or other subsidized forms of benefit).

(E) Permitted disparity is imputed, to the extent possible, under paragraph (d)(5)(iv) of this section with respect to all other defined benefit plans in the testing group, but only for employees not benefiting under the excess plan or offset plan.

(F) Any plan provision, including an amendment, granting past service credit under the excess or offset plan does not have the effect of discriminating significantly in favor of highly compensated employees. Whether such a provision causes significant discrimination is determined under the principles described in paragraph (d)(4)(ii) of this section.

(ii) *Uniform compensation assumption.* For purposes of imputing disparity under paragraphs (d)(4)(iv) and (d)(5)(iv) of this section, the compensation of an employee who is currently benefiting only under one or more plans in the testing group that do not determine benefit accruals or allocations by reference to individual employees' compensation (for example, plans granting flat dollar accruals for each year of service) may be deemed to be equal to the average compensation of all nonexcludable employees benefiting under such plans. In addition, the covered compensation of the employee may be calculated based on the average age of all such nonexcludable employees benefiting under such plans. Covered compensation is defined in §1.401(l)-1(b)(9).

(7) *Three-year averaging period*—(i) *General rule.* An employer may calculate an employee's employee benefit percentage for a testing period as the average of the employee's employee benefit percentages calculated separately for the testing period and for the immediately preceding one or two testing periods (referred to in this section as an "averaging period").

(ii) *Consistency rule.* Employee benefit percentages that are averaged together within an averaging period must be calculated on a consistent basis. Thus, for example, they must be calculated as a percentage of the same definition of compensation.

(8) *Alternative definitions of compensation*—(i) *Compensation formulas.* Compensation determined under a compensation formula that satisfies §1.401(a)(4)-3(f)(2) may be used in lieu of an employee's current compensation in paragraph (d)(5)(iii) of this section. Except as provided in paragraph (e)(8)(iii) of this section, the same formula must be used to calculate all employee benefit percentages under the testing group for a testing period. In addition, the compensation taken into account under the formula must be determined based on the plan year of the plan or plans that use the compensation formula to determine benefits. Thus, for example, employee benefit percentages under a testing group that includes a calendar year plan which determines employees' accrued benefits on the basis of their career average W-2 compensation may generally be calculated using career average calendar-year W-2 compensation in lieu of current compensation in paragraph (d)(5)(iii).

(ii) *Special rule for determining whether alternative definitions are discriminatory.* A definition of compensation not described in §1.414(s)-1T(c) (for example, W-2 compensation) generally may not be used in paragraph (d)(4)(iii) or (d)(5)(iii) unless it satisfies the nondiscrimination requirements of §1.414(s)-1T(d)(2). For purposes of the average benefit percentage test, these requirements must be satisfied with respect to all employees taken into account in determining whether the test is satisfied. Similarly, under §1.401(a)(4)-3(f)(2), a compensation formula that takes into account compensation determined under a definition not described in §1.414(s)-1T(c) generally may not be used in lieu of current compensation in paragraph (d)(5)(iii) of this section unless the definition of compensation taken into account satisfies the same nondiscrimination requirements. These nondiscrimination requirements are deemed to be met for purposes of the average benefit percentage test, however, if it is reasonable to believe that the definition used does not result in an average benefit percentage that is significantly higher than the average benefit percentage that would be determined using a definition that actually satisfied those requirements with respect to all employees.

(iii) *Use of different definitions for certain groups of employees.* A definition of compensation or compensation formula may be used in paragraphs (d)(4)(iii) and (d)(5)(iii) to calculate employee benefit percentages for all employees benefiting under a plan or group of plans in a testing group, if the definition or formula would satisfy section 414(s) or §1.401(a)(4)-3(f)(2), respectively, if the nondiscrimination requirements of those sections were applied solely with respect to that group, and if it is reasonable to believe that the definition used will not result in an average benefit percentage that is significantly higher than the average benefit percentage that would be determined using a definition that satisfied those requirements with respect to all employees. In the case of a compensation formula, this rule is only available for purposes of paragraph (d)(5)(iii) of this section.

(9) *Additional rules.* The Commissioner may, in revenue rulings, notices, and other guidance of general applicability, provide additional rules for calculating average benefit percentages, including rules limiting the use of any of the optional methods provided in this paragraph (e).

Par. 6. Section 1.410(b)-10 as proposed on May 18, 1989, (54 FR 21437) is amended by revising paragraph (a) and adding paragraph (d) to read as follows:

§1.410(b)-10 Effective dates and transition rules.

(a) *General rule.* The minimum coverage rules of section 410(b), as amended by section 1112 of the Tax Reform Act of 1986, and the provisions of §1.410(b)-2 through -9, other than §1.410(b)-5, apply to plan years beginning on or after January 1, 1989. See paragraph (d) of this section for the effective date of §1.410(b)-5.

* * * * *

(d) *Effective date for average benefit percentage test.* Section 1.410(b)-5 applies to plan years beginning on or after January 1, 1991. For plan years beginning before that date and on or after the first day of the first plan year to which the amendments made to section 410(b) by section 1112(a) of

the Tax Reform Act of 1986 apply, a plan must be operated in accordance with a reasonable, good faith interpretation of sections 410(b)(2)(A)(ii) and 410(b)(2)(B) through (E). Whether a plan is operated in accordance with a reasonable, good faith interpretation of those sections will generally be determined on the basis of all relevant facts and circumstances, including the extent to which an employer has resolved unclear issues in its favor. A plan will be deemed to be operated in accordance with a reasonable, good faith interpretation of those sections if it is operated in accordance with the terms of §1.410(b)-5.

Par. 7. A-1 of §1.411(d)-4 as published on July 11, 1988, (53 FR 26050) is amended by adding the following sentence at the end of paragraph (b)(1):

§1.411(d)-4 Section 411(d)(6) protected benefits.

* * * * *

A-1: * * *

(b) *Optional forms of benefit*—(1) *In general.** * * See §1.401(a)(4)-4(d) for the definition of an optional form of benefit for plan years beginning on or after the later of January 1, 1991, or the first day of the first plan year for which the amendments made to section 410(b) by section 1112(a) of the Tax Reform Act of 1986 apply to a plan.

* * * * *

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on May 10, 1990, 8:45 a.m., and published in the issue of the Federal Register for May 14, 1990, 55 F.R. 19897)

Notice of Proposed Rulemaking

Employee Business Expenses—Reporting and Withholding on Employee Business Expense Reimbursements and Allowances

EE-8-89

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In *** [T.D. 8276, page 14, this Bulletin], the Internal Revenue Service is issuing temporary regulations relating to the taxation of and reporting and withholding on employee business expense reimbursements and other expense allowance arrangements. The text of those temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATE: Written comments and requests for a public hearing must be delivered or mailed before February 12, 1990. The income tax provisions of these rules are effective for taxable years beginning on or after January 1, 1989. The reporting provisions of these rules are effective for payments made under reimbursement or other expense allowance arrangements on or after January 1, 1989; however, a transition rule is provided for payments made prior to January 1, 1990. The provisions of these rules regarding withholding and payment of employment taxes are effective for payments made under reimbursement or other expense allowance arrangements on or after July 1, 1990.

ADDRESS: Send comments and requests for a public hearing to Internal Revenue Service, Attention: CC:CORP:T:R (EE-8-89), Room 4429, Washington, D.C. 20224.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1980 (44 U.S.C. 3504(h)). Comments on the collection of information should be sent to the Office of Management and Budget, Paperwork Reduction Project, (1545-1148), Washington, D.C. 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer T:FP, Washington, D.C. 20224.

The collection of information in this regulation is in §1.62-2T. This information is required by the Internal Revenue Service to comply with section 62(c) of the Internal Revenue Code. This information will be used to determine whether amounts paid under a reimbursement or expense allowance arrangement are treated as paid under an accountable plan. The likely recordkeepers are individual employees. These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual recordkeepers may require greater or less time, depending on their particular circumstances. Estimated total annual recordkeeping burden: 709,728 hours. The estimated average annual burden per recordkeeper is 30 minutes.
Estimated number of recordkeepers: 1,419,456.

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under sections 62, 162, 274, and 6041 of the Internal Revenue Code and to the Employment Tax Regulations (26 CFR Part 31) under sections 3121, 3231, 3306, and 3401 of the Internal Revenue Code.

The temporary regulations contain rules concerning the taxation of and reporting and withholding on payments with respect to employee business expenses under a reimbursement or other expense allowance arrangement. For the text of the temporary regulations, see T.D. 8276 *** [page , this Bulletin]. The preamble to the temporary regulations explains the regulations.

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Admin-

istrator of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted, consideration will be given to any written comments that are submitted (preferably eight copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Internal Revenue Service by any person who also submits written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

Fred T. Goldberg,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 7, 1989, 12:20 p.m., and published in the issue of the Federal Register for December 12, 1989, 54 F.R. 51038)

Notice of Proposed Rulemaking

Miscellaneous Regulations for Qualified Plans

EE-22-90

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations about the $200,000 compensation limit under section 401(a)(17) of the Internal Revenue Code. This document also contains amendments to previously proposed regulations under sections 401(k), 401(l), 401(m), and 410(b) of the Code. These proposed regulations reflect changes made by the Tax Reform Act of 1986 [Pub. L. 99-514, 1986-3 C.B. (Vol. 1)] and by the Technical and Miscellaneous Revenue Act of 1988 [Pub. L. 100-647, 1988-3 C.B. 1]. These regulations will provide the public with guidance necessary to comply with the law and will affect sponsors of and participants in tax-qualified retirement plans.

DATES: Written comments must be received by July 13, 1990. Requests to speak (with outlines of oral comments) at a public hearing scheduled for Wednesday, September 26, 1990, at 10:00 a.m., and continuing at 10:00 a.m. each day, if necessary, on Thursday, September 27, 1990, and Friday, September 28, 1990, must be received by Wednesday, September 12, 1990. See notice of hearing published elsewhere in * * * [Announcement 90-78, 1990-23 I.R.B. 50].

ADDRESSES: Send comments and requests to speak (with outlines of oral comments) at the public hearing to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Attn: CC:CORP:T:R (EE-22-90), Room 4429, Washington, D.C. 20044.

SUPPLEMENTARY INFORMATION:

Statutory Authority

This document contains proposed regulations under section 401(a)(17) of the Internal Revenue Code (Code) and amendments of previously proposed regulations under sections 401(k), 401(l), 401(m), and 410(b) of the Code. These regulations and amendments are proposed to conform the regulations to sections 1106, 1111, 1112, 1114, 1116, and 1117 of the Tax Reform Act of 1986 (TRA '86) [Pub. L. 99-514, 1986-3 C.B. (Vol. 1)] and section 1011(d)(4), (d)(5), (d)(6), (i)(2), and (i)(3) of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) [Pub. L. 100-647, 1988-3 C.B.]. These regulations are to be issued under the authority contained in sections 401(a)(17), 401(l)(5)(F), 401(m)(9), 410(b)(6)(G), and 7805 of the Code.

Background

These proposed regulations, along with three other sets of regulations proposed simultaneously, constitute an integrated effort to implement TRA '86 (as amended) while lessening the burdens of taxpayer compliance with the statutory provisions applicable to tax-qualified plans. These proposed regulations, like those under section 401(a)(4), are intended to provide guidance that is clear, simple, and administrable.

The amendments made to the outstanding proposed regulations under section 401(l) reflect the simplification and liberalization of those rules that is now permitted with the promulgation of comprehensive regulations under section 401(a)(4). Other amendments made to the outstanding proposed regulations under sections 401(k), 401(l), 401(m), and 410(b) are a direct result of comments made by taxpayers and practitioners for simplification of certain provisions of those regulations.

Many other comments were received on the proposed regulations under sections 401(k), 401(l), 401(m), and 410(b). The Treasury Department and the Internal Revenue Service are still evaluating those comments. Thus, the failure to reflect those comments in the proposed amendments to the regulations under sections 401(k), 401(l) and 401(m) should not give rise to any inference that those comments will not be addressed in the final regulations.

Section 401(a)(17) $200,000 Limit

Section 401(a)(17) provides an annual compensation limit for each employee under a qualified plan. This limit applies to a qualified plan in two ways. First, a plan may not base contributions or benefits on compensation in excess of the annual limit. Thus, a plan does not satisfy section 401(a)(17) unless it provides that an employee's compensation in excess of the annual limit is not used in determining plan benefits or contributions for a plan year to which the annual limit applies.

Second, the amount of an employee's annual compensation that may be taken into account in applying certain specified nondiscrimination rules under the Code is subject to the annual limitation. Thus, in determining the allocation rates for defined contribution plans and the accrual rates for defined benefit plans, an employee's compensation in excess of the annual limit is disregarded in applying those nondiscrimination rules. The annual compensation limit applies separately to each group of plans that is treated as a single plan for purposes of the applicable nondiscrimination requirement.

The annual limit, which applies for plan years beginning after December 31, 1988, is $200,000 adjusted annually for years after 1989. The proposed regulations provide that the benefits

or contributions accrued under a plan for plan years prior to the effective date of section 401(a)(17) are not subject to the annual compensation limit. Thus, an employee's accruals or allocations prior to the 1989 plan year that are based on compensation in excess of the annual compensation limit need not reduce or affect the employee's accruals in subsequent years. However, benefits or contributions accruing or allocated for any plan year subject to section 401(a)(17) may not take into account compensation in excess of the annual compensation limit applicable to that plan year. For this purpose, the annual limit for plan years prior to the effective date of section 401(a)(17) is $200,000. For example, if a defined benefit plan bases benefits on final average pay over 3 years, and an employee earned $300,000 in 1987, 1988, and 1989, then in determining the 1989 plan year accrual, the compensation taken into account for each year must be limited to $200,000.

The proposed regulations also provide that any increase in the annual compensation limit applies only to compensation taken into account for the year of the increase and subsequent years and does not apply to compensation for prior years that are used in determining an employee's benefit. Therefore, if an employer has a defined benefit plan that bases benefits on the average of an employee's three highest years of compensation, each year's compensation used in the average is limited to the annual compensation limit in effect for that year. For example, assume an employee's compensation was $300,000 in 1989, 1990 and 1991, and that the annual compensation limit increases to $209,200 in 1990 and $220,000 in 1991. If a plan uses all three years in computing the employee's 1991 accrual, then compensation of $209,733 (the average of $200,000, $209,200 and $220,000) is taken into account for determining the accrual.

The proposed regulations do not address the effect of the family aggregation rules of section 414(q)(6) on the annual compensation limit. Guidance on this issue will be published in the near future.

Section 401(k) and (m), Cash or Deferred Arrangements and Employee and Matching Contributions

1. *Background*

Section 401(k) of the Code provides, in general, that a qualified cash or deferred arrangement is an arrangement which is part of a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan under which an eligible employee may elect to have the employer make certain payments to a trust under the plan on behalf of the employee or to the employee in cash. On November 10, 1981, proposed regulations (46 FR 55544) regarding cash or deferred arrangements were published in the Federal Register.

Sections 1116 and 1117 of the Tax Reform Act of 1986 (TRA '86) made several changes affecting cash or deferred arrangements (CODAs) and employee and matching contributions. On August 8, 1988, the Service issued final regulations (53 FR 29658, T.D. 8217) relating to cash or deferred arrangements described under section 401(k). Proposed regulations (53 FR 29719) relating to CODAs and nondiscrimination requirements for employee and matching contributions under section 401(m) reflecting the changes made by TRA '86 were published in the Federal Register on the same day. Further guidance in this area was provided by Notice 88-127, 1988-2 C.B. 538, and Revenue Procedure 89-65, 1989-2 C.B. 786.

2. *Family Aggregation*

The regulations proposed on August 8, 1988, required a two-step method for aggregating family members to determine the actual deferral percentage (ADP) and the actual contribution percentage (ACP) of a family. In some cases, the correction of excess contributions of highly compensated family members subject to the family aggregation rules of section 414(q)(6) also required a two-step process. In response to several comments, the proposed regulations have been simplified by eliminating the more complex method and substituting a straightforward calculation for aggregation of family members. The method for correction of excess contributions of the highly compensated family members is also simplified. The proposed rules relating to family aggregation are effective for plan years beginning after December 31, 1986. However, for plan years beginning before January 1, 1991, taxpayers can choose to use either this method or the method described in the proposed regulations of August 8, 1988.

3. *Multiple Use of the Alternative Limitation under Section 401(k) and (m)*

TRA '86 substantially tightened the nondiscrimination rules applicable to employee and matching contributions. For example, section 401(m)(9)(A) of the Code provides that, for plan years after 1986, regulations are to prohibit multiple use of the alternative limitation (the 200 percent/two percentage point limitation on contributions by or for highly compensated employees). Effective for plan years beginning in 1989, §1.401(m)-2 of the proposed regulations provides a combined limit on the sum of the ADP and ACP of the highly compensated employees. The limit equals the sum of two numbers calculated using formulas prescribed by the proposed regulations.

Several commentators stated that the rules in the proposed regulations were too restrictive for plans in which the ADP or ACP of nonhighly compensated employees was less than 2 percent, and both the ADP and ACP of the highly compensated employees exceeded the normal (125 percent) limits, but were less than the alternative limits. For example, assume that the ADPs for highly compensated employees and nonhighly compensated employees are 3.9 percent and 2.0 percent, respectively, while the ACPs for the two groups are 1.3 percent and 1.0 percent, respectively. The sum of the ADP and ACP for the highly compensated employees is 5.2 percent. The 1988 proposed regulations would limit the sum to 4.5 percent. Accordingly, the prohibited multiple use would occur.

In response to those comments, these proposed regulations significantly liberalize the multiple use limitation by modifying the aggregate limit to provide more appropriate results in these situations. In the above example, the sum would be limited to 5.25 percent, which equals the sum of the normal limit on the ACP (1.25 percent) and the alternative limit on the ADP (4.0 percent). No prohibited

multiple use would occur. The regulations also clarify that multiple use of the alternative limitation will not occur unless the ADP and ACP of the group of highly compensated employees each exceeds 125 percent of the corresponding percentage of the group of nonhighly compensated employees. For plan years beginning before January 1, 1991, taxpayers can choose to use either this method or the method described in the proposed regulations of August 8, 1988.

Section 401(l), Permitted Disparity—Integration

Proposed regulations under section 401(l) were published on November 15, 1988 (53 FR 45917). In response to public comments, the proposed regulations are amended in five respects, as described in the following discussion.

The first amendment deals with the definition of average annual compensation under proposed §1.401(l)-1(b)(8). The general definition requires that the determination of average annual compensation be based on the participant's entire period of participation. Comments on the definition of average annual compensation focused on the problem of keeping compensation records for employees' entire careers. They also suggested that, under old law, employers were required to keep records for only the past 10 years. In many cases, records for earlier years are therefore not available. The amendment responds to those comments by allowing a plan to disregard years before the employee's 10 most recent years of employment. This change is intended to reduce the administrative requirements associated with the definition of average annual compensation.

The second amendment concerns the definition of covered compensation in proposed §1.401(l)-1(b)(9). After publication of the proposed regulations, Notice 89-70, 1989-1 C.B. 730, was issued to provide employers with alternative methods to determine covered compensation. In most instances, an employer must use an individualized amount of covered compensation for each employee, depending on the employee's year of birth, or use a reduced rate of permitted disparity. The proposed regulations are now amended to allow employers to determine covered compensation in a simplified manner, using an alternative table for 1989 that is based on rounding of actual covered compensation amounts to multiples of approximately $3,000. The 1989 table contains fewer brackets of covered compensation and will allow employers to use the same amount of covered compensation for a larger number of employees. Additional tables for future years will be published by the Commissioner and will provide comparable methods for determining covered compensation.

The third amendment creates two additional exceptions to the uniformity requirements for defined benefit plans contained in proposed §1.401(l)-3(b)(2)(i) and §1.401(l)-3(c)-(2)(i). The regulations proposed on November 15, 1988, require that, in the case of an excess plan, the difference between the excess benefit percentage and the base benefit percentage be uniform for all participants. Similarly, in the case of an offset plan, the amount of the offset, when expressed as a percentage of final average compensation, must be uniform for all participants. The regulations proposed on November 15, 1988, provide an exception to the uniformity requirement if nonuniformity results merely from adjustments for different social security retirement ages. Comments on these proposed regulations requested that plans be permitted to provide an additional benefit with respect to years of service in excess of 35 or to offer multiple formulas to all employees without violating the uniformity requirement.

In response to those comments, the amendments in this document establish a new exception if nonuniformity results merely from the fact that the plan provides an integrated benefit for years of service up to 35 and a nonintegrated benefit for service in excess of 35 years and accrues the total benefit under the fractional rule of section 411(b)(1)(C). In addition, the amendments clarify that a plan does not violate the uniformity requirement merely because it contains two or more benefit formulas and provides each participant with the greatest benefit that results under any of the formulas. These amendments allow employers more flexibility in designing plan formulas that will meet the requirements of section 401(l).

The fourth amendment deals with the transition rules in the proposed regulations. Section 1.401(l)-3(l)(3) as proposed on November 15, 1988, allows a plan to provide employees with a total benefit consisting of the benefit that had accrued as of the close of the last plan year beginning before January 1, 1989, plus the benefit that accrues under the new rules of section 401(l) for plan years beginning after December 31, 1988. The proposed regulations require that a participant's accrued benefit as of the close of the last plan year beginning before January 1, 1989, be determined as if the participant terminated employment on that date.

Many commentators suggested that, in the case of a plan that bases benefits on an employee's final pay, the plan be permitted to increase the pre-1989 frozen benefit to reflect post-1988 pay increases, without having to apply section 401(l) to the entire accrued benefit. In response to those comments, the amendments in this document allow certain plans that base a participant's accrued benefit on the participant's final compensation to take compensation for plan years beginning after 1988 into account in determining the participant's accrued benefit. This rule applies to an excess plan that, as of the close of the last plan year beginning before January 1, 1989, provided (or is amended to provide) a base benefit at a rate that is at least one-half of the rate at which an excess benefit is provided. It also applies to an offset plan that, as of that date, did not offset (or is amended not to offset) the benefit, determined prior to the application of the offset, by more than one-half. The calculation of an accrued benefit under these rules must be applied uniformly to all participants who have an hour of service in any plan year beginning after December 31, 1988.

The last amendment deals with the overall permitted disparity rules of §1.401(l)-4(a), which are intended to prevent multiple utilization of the permitted disparity in the case of an employee who participates in more than one plan maintained by an employer. Comments on the proposed regulations suggested that a plan be

permitted to offer multiple formulas to all employees without applying the overall permitted disparity rules. Section 1.401(l)-4(a)(1) is amended to make it clear that a plan that contains two or more formulas, each of which comes within the maximum permitted disparity, and that provides a participant with the greatest benefit that results under any of the formulas need not subject the combined benefit under the various formulas to a single permitted disparity limit.

Section 410(b) Minimum Coverage Requirements

This document includes three amendments to the proposed regulations under section 410(b) that were published in the Federal Register on May 18, 1989 (54 FR 21437).

Representatives of governmental plans commented that the effective date of the proposed section 410(b) regulations did not provide them with adequate time to amend their plans to come into compliance with those proposed regulations. They commented that this was especially true in the case of state governments that had biennial legislative sessions. Proposed §1.410(b)-2 is therefore amended to provide that governmental plans as defined in section 410(c)(1)(A) will automatically satisfy the coverage rules of section 410(b) for plan years beginning before January 1, 1993.

Second, proposed §1.410(b)-6 is amended to provide that if a plan uses the special minimum age and service conditions permitted under section 410(a)(1)(B), then all employees who do not satisfy those conditions may be treated as excludable employees for purposes of testing under section 410(b). Thus, if a plan contains a 2-year eligibility requirement, with 100 percent vesting after completion of 2 years, it may treat employees who have less than 2 years of service as excludable employees for purposes of section 410(b).

Third, proposed §1.410(b)-9 is amended to limit the definition of "professional" to highly compensated employees who otherwise meet the definition of professional under that section. Thus, for example, under the proposed regulation, an engineer is a "professional" only if the engineer is also a highly compensated employee. This change results in a consistent definition under sections 410(b) and 401(a)(26).

Effective Date

1. *Proposed §1.401(a)(17)-1*

The regulations under section 401(a)(17) are proposed to be effective for plan years beginning on or after January 1, 1991. For plan years beginning before that date but on or after the date that section 401(a)(17) first applies to a plan, the plan must be operated in accordance with a reasonable good faith interpretation of the requirements of section 401(a)(17). Whether compliance is reasonable and in good faith will be determined on the basis of all the facts and circumstances, including the extent to which the employer has resolved unclear issues in its favor. Reasonable, good faith compliance will be deemed to exist, however, if a plan is operated in accordance with proposed §1.401(a)(17)-1.

To provide governmental plans adequate time to amend their plans to come into compliance with section 401(a)(17), a special effective date is provided for governmental plans. The regulations provide that governmental plans as defined in section 414(d) will automatically satisfy the requirements of section 401(a)(17) for plan years beginning before January 1, 1993.

2. *Amended portions of previously proposed regulations*

Apart from proposed §1.401(a)-(17)-1, this document consists of amendments to previously proposed regulations under sections 401(k), 401(l), 401(m), and 410(b). These amended portions are proposed to be effective as previously set forth in the prior notices of proposed rulemaking to which they relate. Employers may, however, choose to use either the amended portions set forth in this document or the previous versions of the proposed regulations for plan years beginning before January 1, 1991. For example, for plan years beginning before January 1, 1991, an employer may choose to use either the section 401(k) and (m) family aggregation rules as proposed to be amended in this document or the family aggregation rules described in the proposed section 401(k) and (m) regulations of August 8, 1988.

Reliance on these proposed regulations

Taxpayers may rely on these proposed regulations for guidance pending issuance of final regulations. If future regulations are more restrictive, such guidance will be applied without retroactive effect.

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Requests to Appear at the Public Hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably a signed original and eight copies) to the Internal Revenue Service. All comments will be available for public inspection and copying in their entirety. Because the Treasury Department expects to issue final regulations on this matter as soon as possible, a public hearing will be held at 10:00 a.m. on September 26, 1990, and continued, if necessary, on September 27 and 28, 1990, in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Ave., N.W., Washington, D.C. Comments must be received by July 13, 1990. Requests to speak (with outlines of oral comments) at the public hearing must be received by Wednesday, September 12, 1990. See notice of hearing published elsewhere in * * * [Announcement 90-78, 1990-23 I.R.B. 50].

List of Subjects

26 CFR 1.401–0 through 1.425–1

Employee benefit plans, Employee stock ownership plans, Income taxes, Individual retirement accounts, Pensions, Stock options.

Proposed amendments to the regulations

The notices of proposed rulemaking (to amend 26 CFR Part 1) that were published on August 8, 1988 (53 FR 29719), November 15, 1988 (53 FR 45917), and May 18, 1989 (54 FR 21437) are amended, and additional amendments to 26 CFR Part 1 are proposed, as follows:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. The authority citation for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * §1.401(a)(17)–1 also issued under 26 U.S.C. 401(a)(17), §1.401(k)–1 also issued under 26 U.S.C. 401(k), §§1.401(l)–1 through (l)–4 also issued under 26 U.S.C. 401(l), §§1.401(m)–1 and (m)–2 also issued under 26 U.S.C. 401(m), and §§1.410(b)–2 through (b)–9 also issued under 26 U.S.C. 410(b).

Par. 2. A new §1.401(a)(17)–1 is added to read as follows:

§1.401(a)(17)–1 Limitation on annual compensation.

(a) *Compensation limit requirement*—(1) *In general.* In order to be a qualified plan, a plan must satisfy section 401(a)(17). Section 401(a)(17) provides an annual compensation limit for each employee under a qualified plan. This limit applies to a qualified plan in two ways. First, a plan may not base contributions or benefits on compensation in excess of the annual limit. Second, the amount of an employee's annual compensation that may be taken into account in applying certain specified nondiscrimination rules under the Code is subject to the annual limitation. These two limitations are set forth in paragraphs (b) and (c) of this section.

(2) *Annual compensation limit.* For purposes of this section, "annual compensation limit" means $200,000, adjusted annually by the Commissioner. The time and manner of these adjustments are the same as under section 415(d), except that the base period is 1989; the first adjustment is effective on January 1, 1990; and the dollar increase in effect on January 1 is effective for years beginning in the calendar year. For example, if a plan has a fiscal year plan year beginning July 1, 1989 and ending June 30, 1990, the annual compensation limit in effect on January 1, 1989 ($200,000) applies to the plan for that plan year. In addition, if compensation for any year beginning prior to the effective date that section 401(a)(17) first applies to a plan is used for determining contributions or benefits, or when applying any nondiscrimination rule, in any year subject to section 401(a)(17), then the annual compensation limit for that prior year is the annual compensation limit for 1989 ($200,000).

(b) *Plan limit on compensation*—(1) *General rule.* A plan does not satisfy section 401(a)(17) unless it provides that the compensation taken into account for any employee in determining plan contributions or benefits for any plan year is limited to the annual compensation limit. In addition, a plan may provide that the amount of compensation subject to the annual compensation limit for a self-employed individual is determined by subtracting from the amount otherwise treated as compensation, the deduction allowed by section 404 to the individual for contributions to the plan on the individual's behalf.

(2) *Plan year by plan year requirement.* For purposes of this paragraph (b), the limit in effect for the current plan year applies only to the compensation for that year that is taken into account in determining plan benefits or contributions for the year. The compensation for any prior plan year taken into account in determining an employee's contributions or benefits for the year is subject to the applicable annual compensation limit in effect for that prior year. Thus, increases in the annual compensation limit apply only to compensation taken into account for the plan year in which the increase is effective. For example, if an employer has a defined benefit plan that bases benefits on the average of an employee's three highest years of compensation, compensation for each of the plan years used in the average must be limited to the annual compensation limit in effect for that year.

(3) *Pre-effective date benefits.* For purposes of this paragraph (b), contributions allocated or benefits accrued under a plan for plan years prior to the effective date of section 401(a)(17) are not subject to the annual compensation limits. Thus, allocations or accruals made in plan years beginning before the date on which section 401(a)(17) first applies to a plan need not limit allocations or accruals after that date.

(4) *Application of limit to a year*—(i) *In general.* For purposes of applying this paragraph (b), the annual compensation limit is applied to the compensation for the plan year on which contributions or benefits for that plan year is based.

(ii) *Compensation for the plan year.* A plan may determine compensation used in determining contributions or benefits based on compensation for the plan year. Alternatively, a plan may determine compensation used in determining contributions or benefits for the plan year for all employees on the basis of a 12-consecutive-month period, or periods, ending within the plan year. If compensation is based on periods, the annual compensation limit applies to compensation for those periods based on the annual compensation limit in effect for the calendar year in which each 12-month period begins.

(iii) *Determination of compensation on less than a 12-month period.* If a plan determines compensation on a period of time that contains fewer than 12 calendar months, then the annual compensation limit is an amount equal to the annual compensation limit for the calendar year in which the compensation period begins multiplied by the ratio obtained by dividing the number of full months in the period by 12. For example, if a defined benefit plan provides that an employee's accrual for the year is based on a 1-month period during the year using only the employee's compensation for that month, then the compensation limit is equal to 1/12 of the annual compensation limit in effect at the beginning of the month. Further, if any plan year contains

fewer than 12 months, the annual compensation limit is an amount equal to that limit multiplied by the ratio obtained by dividing the number of months in the short year by 12. No proration is required, however, for employees who are covered under a plan for less than 1 full year if the plan formula for allocations or accruals is based on compensation for a period of at least 12 months.

(5) *Examples.* The following examples illustrate the rules in this paragraph (b):

Example 1. Plan X is a defined benefit plan and bases benefits on an employee's high 3 consecutive years' compensation. Section 401(a)(17) applies to Plan X in 1989. Employee B's high 3 consecutive years' compensation prior to the application of the annual compensation limits is $215,000 (1989), $200,000 (1988) and $185,000 (1987). To satisfy paragraph (b) of this section, Plan X cannot base plan benefits for Employee B in 1989 on compensation in excess of $195,000 (the average of $200,000 (B's 1989 compensation capped by the annual compensation limit), $200,000 (B's 1988 compensation) and $185,000 (B's 1987 compensation)). For purposes of determining the 1989 accrual, each year (1989, 1988 and 1987), not the average of the 3 years, is subject to the 1989 annual compensation limit of $200,000.

Example 2. Assume the same facts as in *Example 1*, except that Employee B's compensation in 1990 is $230,000, and that the 1990 annual compensation limit is $209,200. Plan X cannot base plan benefits for Employee B in 1990 on compensation in excess of $203,067 (the average of $209,200 (B's 1990 compensation capped by the 1990 limit), $200,000 (B's 1989 compensation capped by the 1989 limit) and $200,000 (B's 1988 compensation)). In calculating plan benefits in 1990, the 1990 annual compensation limit applies to the 1990 year only. The 1989 year is capped by the 1989 annual compensation limit. Each year used in the average, including the 1988 plan year, is subject to the applicable annual compensation limit for that year.

Example 3. Assume the same facts as *Example 1*, except that Employee B's high 3 consecutive years' compensation prior to the application of the limits is $230,000 (1989), $220,000 (1988) and $210,000 (1987). To satisfy paragraph (b) of this section, Plan X cannot base plan benefits for Employee B in 1989 on compensation in excess of $200,000 (the average of $200,000 (B's 1989 compensation capped by the 1989 annual compensation limit), $200,000 (B's 1988 compensation capped by the 1989 annual compensation limit), and $200,000 (B's 1987 compensation capped by the 1989 annual compensation limit)).

Example 4. Plan Y is a calendar year defined benefit plan providing an annual benefit for each year of service equal to 2 percent of compensation averaged over an employee's high 3 consecutive years' compensation. The plan determines an employee's accrual based on an employee's compensation during the calendar year. As of the close of the plan year prior to the year that section 401(a)(17) applies to Plan Y (1988), Employee A, with 5 years of service, had accrued a benefit of $25,000 which equals 10 percent (2 percent multiplied by 5 years of service) of average compensation of $250,000. Effective for plan years after December 31, 1988, Plan Y is amended to provide that in determining an employee's benefit, compensation taken into account is subject to the annual compensation limit under section 401(a)(17), but the plan formula is not otherwise amended. Thus, under Plan Y's formula, Employee A's accrued benefit at the end of 1989 is $25,000 which is the greater of Employee A's section 411(d)(6) protected benefit ($25,000) and $24,000 which is Employee A's benefit based on the plan's formula ($200,000 multiplied by (2 percent multiplied by 6 years of service)). Plan Y, as amended, satisfies the requirements of section 401(a)(17).

Example 5. Assume the same facts as in *Example 4*, except that the plan formula provides that effective January 1, 1989, an employee's benefit will equal the sum of an employee's accrued benefit as of December 31, 1988 and 2 percent of compensation averaged over an employee's high 3 consecutive years' compensation times years of service taking into account only years of service after December 31, 1988. Thus, under Plan Y's formula, Employee A's accrued benefit at the end of 1989 is $29,000 which is equal to the sum of $25,000 (Employee A's accrued benefit at the end of 1988) plus $4,000 ($200,000 multiplied by (2 percent multiplied by 1 year of service)). Plan Y, as amended, satisfies section 401(a)(17).

Example 6. Assume the same facts as *Example 4*, except that the plan formula provides that effective January 1, 1989, an employee's benefit equals the greater of the plan formulas in *Example 4* and *Example 5*. Thus, under Plan Y's formula, Employee A's accrued benefit at the end of 1989 is $29,000 which is equal to the greater of $25,000 and $29,000. Plan Y, as amended, satisfies section 401(a)(17).

Example 7. Assume the same facts as in *Example 6*. As of December 31, 1993, Employee A's average compensation is equal to $300,000. Assume that the annual compensation limit is adjusted to $250,000, $260,000, and $270,000 for plan years beginning after January 1, 1991, 1992 and 1993, respectively. The compensation that may be taken into account for the 1993 plan year cannot exceed $260,000 (the average of $250,000, $260,000 and $270,000). Therefore, at the end of 1993, the first amount would be $52,000 ($260,000 multiplied by (2 percent multiplied by 10 years of service)). The second amount would be $51,000 which is equal to $25,000 (Employee A's accrued benefit as of the end of 1989) and $26,000 ($260,000 multiplied by (2 percent multiplied by 5 years of service)). Thus, because Employee A's accrued benefit is equal to the greater of the two amounts, Employee A's accrued benefit at the end of 1993 is $52,000.

Example 8. Plan Z is a defined benefit plan that bases benefits on an employee's high consecutive 36 months of compensation ending within the plan year. Employee C's high 36 months are the period September 1989 to August 1992 in which Employee C earned $50,000 in each month. Assume that the annual compensation limit is $200,000, $209,200 and $220,000 in 1989, 1990 and 1991 respectively. To satisfy paragraph (b) of this section, Plan Z cannot base plan benefits for Employee C on compensation in excess of $209,733 for the 1992 plan year. This amount is determined by applying the applicable annual compensation limit to compensation for each of the three 12-consecutive-month periods. The September 1989 to August 1990 period is capped by the annual compensation limit of $200,000 for 1989, the September 1990 to August 1991 period is capped by the annual compensation limit of $209,200 for 1990, and the September 1991 to August 1992 period is capped by the annual compensation limit of $220,000 for 1991. The average of these capped amounts is the annual compensation limit for determining benefits for the 1992 year.

(c) *Limit on compensation for nondiscrimination rules*—(1) *General rule.* The annual compensation limit applies for purposes of applying the nondiscrimination rules under sections 401(a)(4), 401(a)(5), 401(l), 401(k)(3), 401(m), and 403(b)(12), and the nondiscrimination rule in the average benefit percentage test under section 410(b)(2). The limit also applies in determining whether an alternative method of determining compensation impermissibly discriminates under section 414(s)(3). This paragraph (c) provides rules for applying the annual compensation limit for these purposes. For purposes of this paragraph (c), "compensation" means the compensation used in applying the applicable nondiscrimination rule.

(2) *Plan year by plan year requirement.* For purposes of this paragraph (c), when applying an applicable nondiscrimination rule for a plan year, the compensation for each plan year taken into account is limited to the applicable annual compensation limit in effect for that year. Thus, if the nondiscrimination provision is applied on the basis of compensation determined over a period of more than one year (for example, final average compensation) the annual compensation limit in effect for each of the plan years used in the average applies to that year's compensation taken into account in determining the average.

(3) *Plan by plan limit.* For purposes of this paragraph (c), each group of plans that is treated as a single plan in determining whether any applicable nondiscrimination requirement is satisfied is subject separately to the annual compensation limit. For example, if Plan A is restructured into component plans under §1.401(a)(4)-9 and each component plan is intended to satisfy sections 401(a)(4) and 410(b), then the annual compensation limit applies separately to each component plan in

Plan A. Similarly, the annual compensation limit applies separately to all plans taken into account in determining whether the average benefit percentage test is satisfied.

(4) *Effect of limit.* For purposes of this paragraph (c), in applying the applicable annual compensation limit under a particular nondiscrimination rule to a year, an employee's compensation for that year in excess of the limit is disregarded.

(5) *Application of limit to a year.* The rules provided in paragraph (b)(4) of this section regarding the application of the limit to a year apply for purposes of this paragraph (c).

(d) *Effective date*—(1) *In general.* This section applies to plan years beginning on or after January 1, 1991. For plan years beginning before that date, and on or after the first day of the first plan year that section 401(a)(17) applies, a plan must be operated in accordance with a reasonable, good faith interpretation of section 401(a)(17). Whether a plan is operated in accordance with a reasonable, good faith interpretation of section 401(a)(17) will generally be determined on the basis of all relevant facts and circumstances, including the extent to which an employer has resolved unclear issues in its favor. A plan will be deemed to be operated in accordance with a reasonable, good faith interpretation of section 401(a)(17) if it is operated in accordance with the terms of this section.

(2) *Transitional rule for governmental plans.* Section 401(a)(17) is considered satisfied for plan years beginning before January 1, 1993, in the case of governmental plans described in section 414(d).

Par. 3. Section 1.401(k)-1 as proposed on August 8, 1988 (53 FR 29719) is amended as follows:

1. Paragraph (f)(5)(iii), Family members, is revised to read as set forth below.

2. In paragraph (f)(7), Example 3 is revised to read as set forth below and Examples 4, 5, and 6 are removed.

3. Paragraph (g)(8)(iii)(A) is revised to read as set forth below.

§1.401(k)-1 Certain cash or deferred arrangements.

* * * * *

(f) Correction of excess contributions * * *

(5) Special rules * * *

(iii) *Correction of family members.* The determination and correction of excess contributions of a highly compensated employee whose actual deferral ratio is determined under the family aggregation rules of paragraph (g)(8) of this section is accomplished by reducing the actual deferral ratio as required under paragraph (f)(2) of this section and allocating the excess contributions for the family group among the family members in proportion to the elective contribution of each family member that is combined to determine the actual deferral ratio.

* * * * *

(7) *Examples* * * *

Example (3). Individual A has a child, B. Both participate in a 401(k) plan maintained by employer X. A is one of the ten most highly compensated employees and B is a nonhighly compensated employee. A has compensation of $100,000 and defers $7,000 under the 401(k) arrangement; B has compensation of $40,000 and defers $4,000 under the arrangement. The actual deferral ratio of the family unit is 7.86%, calculated by aggregating the contributions and compensation of A and B ($7,000 + $4,000)/($100,000 + $40,000). For the plan, it is determined that under §1.401(k)-1(f), the actual deferral ratio of the aggregate family unit must be reduced to 7.20%. This reduction is applied in proportion to both A and B's contributions. The excess contributions are $920 ($11,000 total contributions minus $10,080 (7.20% x $140,000)). A's share of the excess contributions is $585.45 ($7,000/$11,000 x $920); B's share is $334.55 ($4,000/$11,000 x $920).

(g) *Definitions* * * *

(8) *Actual deferral percentage* * * *

(iii) *Aggregation of family members* (A) For plan years beginning after December 31, 1986, or any later date provided in paragraph (h) of this section, if an eligible highly compensated employee is subject to the family aggregation rules of section 414(q)(6) because that employee is either a five percent owner or one of the ten most highly compensated employees, the combined actual deferral ratio for the family group (which is treated as one highly compensated employee) must be determined by combining the elective contributions, compensation, and amounts treated as elective contributions of all the eligible family members. * * *

(B) * * *

* * * * *

Par. 4. Section 1.401(l)-1, as proposed on November 15, 1988 (53 FR 45917), is amended by revising paragraphs (b)(8) and (b)(9) to read as follows:

§1.401(l)-1 Permitted disparity with respect to employer contributions or employer-derived benefits.

* * * * *

(b) *Definitions* * * *

(8) *Average annual compensation.* A participant's average annual compensation, as of a plan year, is the average of the participant's annual compensation from the employer for the consecutive year period during which the average of the participant's annual compensation is the highest. The consecutive year period must consist of at least 3 consecutive years (or, if less, the participant's entire period of credited service). The plan is permitted to limit the years taken into account in determining which 3 or more year period constitutes the period of highest average annual compensation to the current plan year and the 9 years beginning before the current plan year. In determining the consecutive year period, the plan may specify any 12-month period as a year, provided the specified 12-month period is applied consistently with respect to all participants. The definition of average annual compensation used in the plan must also be applied consistently with respect to all participants. If, as of a plan year, a participant's entire period of service for the employer is less than the consecutive year period specified in the plan for determining the participant's average annual compensation, the participant's average annual compensation shall be determined by averaging (on an annual basis) the compensation received by the participant from the employer during the participant's entire period of service for the employer.

(9) *Covered compensation*—(i) *In general.* A participant's covered compensation, for a plan year, is the average (without indexing) of the taxable wage bases in effect for each calendar year during the 35-year period ending with the last day of the calendar year preceding the calendar year in which the participant attains (or will attain) social security retirement age (as defined in section 415(b)(8)). In determining a partici-

pant's covered compensation for a plan year, the taxable wage base for the current plan year and any subsequent plan year is assumed to be the same as the taxable wage base in effect as of the beginning of the plan year for which the determination is being made. A participant's covered compensation for a plan year after the 35-year period described in this paragraph (b)(9) is the participant's covered compensation for the plan year during which the participant attained social security retirement age. A participant's covered compensation for a plan year before the 35-year period described in this paragraph (b)(9) is the taxable wage base in effect as of the beginning of the plan year. A plan must provide that a participant's covered compensation is automatically adjusted for each plan year. See paragraph (c) of this section for rules relating to prohibited decreases in a participant's accrued benefit within the meaning of section 411(d)(6) or section 411(b)(1)(G).

(ii) *Special rule.* For purposes of determining the amount of an employee's covered compensation under paragraph (b)(9)(i) of this section (as modified by the Commissioner), a plan may use the following table for the 1989 plan year. Tables for years after 1989 will be provided by the Commissioner.

1989 TABLE

Year of birth	*Covered Compensation*
1924–1926	$18,000
1927–1928	$21,000
1929–1930	$24,000
1931–1933	$27,000
1934–1935	$30,000
1936–1937	$33,000
1938–1939	$36,000
1940–1942	$39,000
1943–1945	$42,000
1946–1950	$45,000
1951 or later	$48,000

* * * * *

Par. 5. Section 1.401(l)-3, as proposed on November 15, 1988 (53 FR 45917), is amended by revising paragraphs (b)(2)(iii) and (b)(2)(iv) and (c)(2)(iii) and (c)(2)(iv) and by adding new paragraphs (g)(2)(vii), (l)(5)(iv) and (l)(7) to read as follows:

§1.401(l)-3 Permitted disparity with respect to employer-derived benefits.

* * * * *

(b) *Defined benefit excess plans* * * *

(2) *Uniform and maximum excess allowance* * * *

(iii) *Deemed uniformity*—(A) *Different social security retirement ages.* For purposes of applying paragraph (b)(2)(i) of this section, the excess benefit percentage under a plan is deemed to exceed the base benefit percentage by an amount that is uniform for all participants even if the excess benefit percentage exceeds the base benefit percentage by an amount that is not uniform for all participants if the differences in those excesses arise merely as a result of differences in social security retirement ages of participants and the corresponding adjustments in the 3/4 of 1 percent factor in the maximum excess allowance required under paragraph (e)(1) of this section.

(B) *Years of service in excess of 35.* The amount by which the excess benefit percentage under the plan exceeds the base benefit percentage is deemed to be uniform for all employees if differences in the amount of the excess result merely from the fact that, for years of service in excess of 35, the plan accrues a benefit at a uniform rate with respect to all compensation and accrues the benefits attributable to all years of service over the employee's entire projected period of service to normal retirement age, as permitted under the fractional rule of section 411(b)(1)(C).

(C) *Multiple formulas.* The amount by which the excess benefit percentage under a plan exceeds the base benefit percentage is deemed to be uniform for all employees if differences in the amount of the excess result merely from the fact that the plan provides for the calculation of an employee's normal retirement benefit under two or more formulas, each of which otherwise satisfies section 401(l) and of this section and each of which is available to all employees, and further provides that an employee will receive the greatest normal retirement benefit that results under any of the formulas.

(D) *Cumulative deemed uniformities.* If differences in the amount by which the excess benefit percentage under a plan exceeds the base benefit percentage result merely from a combination of any two or more of the circumstances described in paragraph (b)(2)(iii)(A), (b)(2)(iii)(B), and (b)(2)(iii)(C) of this section, the amount of the excess will be deemed to be uniform for all employees.

(iv) *Examples.* Paragraph (b)(2) of this section is illustrated by the following examples.

Example 1. Plan A has a normal retirement age of 65, and benefits participants with social security retirement ages of 65, 66, and 67. There are no other plan benefits or features requiring adjustment of the 3/4 of 1 percent factor in the maximum excess allowance. The excess benefit percentage under the plan is 2%. The base benefit percentage is 1.25% for participants with a social security retirement age of 65. For participants with a social security retirement age of 66, the base benefit percentage is 1.30%, and for participants with a social security retirement age of 67, the base benefit percentage is 1.35%. The lack of uniformity in the amount by which the excess benefit percentage exceeds the base benefit percentage is solely the result of differences in participants' social security retirement ages and the corresponding adjustments in the 3/4 of 1 percent factor in the maximum excess allowance required under paragraph (e)(1) of this section. (Because Plan A effectively provides unreduced benefits prior to the social security retirement age for participants with social security retirement ages of 66 and 67, the 3/4 of 1 percent factor in the maximum excess allowance must be reduced to .70% and .65%, respectively.) Thus, under paragraph (b)(2)(iii)(A) of this section, the amount by which the excess benefit percentage exceeds the base benefit percentage is deemed to be uniform for purposes of paragraph (b)(2) of this section. Alternatively, Plan A could satisfy paragraph (b)(2) of this section if it provided a uniform rate disparity of .65% for all participants by providing a base benefit percentage of 1.35% and an excess benefit percentage of 2% (i.e., .65% is the maximum excess allowance under the plan for a participant with a social security retirement age of 67).

Example (2). (a) Plan A is a defined benefit plan that uses a normal retirement age of 65. All employees under the plan have a social security retirement age of 65, and there are no other plan benefits or features requiring adjustment of the 3/4 of 1 percent factor in the maximum excess allowance. The formula for determining benefits under the plan provides a benefit of 1.0% of average annual compensation up to covered compensation, multiplied by years of service up to 35, and a benefit of 1.75% of average annual compensation in excess of covered compensation, multiplied by years of service up to 35, and a benefit of 1.75% of average annual compensation, multiplied by years of service in excess of 35. Plan A uses the fractional rule for purposes of determining an employee's accrued benefit. Employees A and B have projected periods of service to normal retirement age of 25 years and 40 years respectively.

(b) Employee A's base benefit percentage is (1.0% x 25)/25 or 1.0% and Employee A's excess benefit percentage is (1.75% x 25)/25 or 1.75%. Thus, the amount by which the excess benefit percentage exceeds the base benefit percentage for Employee A is (1.75% - 1.0%)

or .75%. Employee B's base benefit percentage is [(1.0% x 35) + (1.75% x 5)]/40 or 1.09375% and Employee B's excess benefit percentage is (1.75% x 40)/40 or 1.75%. Thus, the amount by which the excess benefit percentage exceeds the base benefit percentage for Employee B is .65625%. Although the amount by which the excess benefit percentage exceeds the base benefit percentage for the two employees is not uniform, under paragraph (b)(2)(iii)(B) of this section, the excess benefit percentage is deemed to exceed the base benefit percentage by a uniform amount for both employees for purposes of paragraph (b)(2) of this section because the difference in the excess results merely from the fact that the entire benefit with respect to years of service in excess of 35 is provided at the excess benefit percentage rate and the total benefit is accrued over the employee's entire projected period of service to age 65.

* * * * *

(c) *Defined benefit offset plans* * * *

(2) *Uniform and maximum offset* * * *

(iii) *Deemed uniformity*—(A) *Different social security retirement ages.* For purposes of applying paragraph (c)(2)(i) of this section, an offset under a plan is deemed to be uniform with respect to all participants even though the amount of the offset, expressed as a percentage of final average compensation, is not uniform with respect to all participants if that lack of uniformity is solely the result of differences in the social security retirement ages of participants and corresponding adjustments in the 3/4 of 1 percent factor in the maximum offset allowance required under paragraph (e)(1) of this section.

(B) *Years of service in excess of 35.* An offset under the plan is deemed to be uniform with respect to all employees if a lack of uniformity results merely from the fact that the employee's benefit under the plan, before application of the offset, is determined with respect to the employee's entire period of service with the employer, no offset is applied with respect to years of service in excess of 35, and the plan accrues both the benefit before application of the offset and the offset over the employee's entire projected period of service to normal retirement age as permitted under the fractional rule of section 411(b)(1)(C).

(C) *Multiple formulas.* An offset under a plan is deemed to be uniform with respect to all employees if a lack of uniformity results merely from the fact that the plan provides for the calculation of an employee's normal retirement benefit under two or more formulas, each of which otherwise satisfies section 401(l) and of this section and each of which is available to all employees, and further provides that an employee will receive the greatest normal retirement benefit that results under any of the formulas.

(D) *Cumulative deemed uniformities.* If differences in the offset under a plan, expressed as a percentage of final average compensation up to covered compensation, result merely from a combination of any two or more of the circumstances described in paragraphs (c)(2)(iii)(A), (c)(2)(iii)(B), and (c)(2)(iii)(C) of this section, the offset will be deemed to be uniform for all employees.

(iv) *Examples.* Paragraph (c)(2) of this section is illustrated by the following examples.

Example (1). Plan A has a normal retirement age of 65, and benefits participants with social security retirement age of 65, 66, and 67. There are no other plan benefits or features that require adjustment to the 3/4 of 1 percent factor in the maximum offset allowance. For each year of service, the plan provides benefits equal to 2% of average annual compensation, reduced by an offset. For participants with a social security retirement age of 65, the offset is .75% of final average compensation not in excess of covered compensation; for participants with a social security retirement age of 66, the offset is .70% of final average compensation not in excess of covered compensation; and for participants with a social security retirement age of 67, the offset is .65% of final average compensation not in excess of covered compensation. The lack of uniformity in Plan A's offset, expressed as a percentage of final average compensation, is solely the result of differences in participants' social security retirement ages and the corresponding adjustments required under paragraph (e)(1) of this section. (Because Plan A effectively provides unreduced benefits prior to the social security retirement age for participants with social security retirement ages of 66 and 67, the 3/4 of 1 percent factor in the maximum offset allowance must be reduced to .70% and .65%, respectively.) Thus, under this paragraph (c)(2)(iii)(A), the amount of the offset is deemed to be uniform for purposes of paragraph (c)(2) of this section. Alternatively, Plan A could satisfy paragraph (c)(2) of this section if it provided a uniform offset of .65% of final average compensation not in excess of covered compensation for all participants (i.e., .65% is the maximum offset allowance under the plan for a participant with a social security retirement age of 67).

Example (2). (a) Plan A uses a normal retirement age of 65. All employees under the plan have a social security retirement age of 65, and there are no other plan benefits or features requiring adjustment to the 3/4 of 1 percent factor in the maximum offset allowance. Plan A provides a benefit of 1.75% of average annual compensation for each year of service, offset by .75% of final average compensation up to covered compensation for each year of service up to 35. Plan A uses the fractional rule for purposes of determining an employee's accrued benefit prior to application of the offset and for determining the employee's offset. Employees A and B, with projected periods of service at normal retirement age of 25 years and 40 years respectively, have average annual compensation and final average compensation of $30,000 and covered compensation of $30,612.

(b) In the case of Employee A, the plan provides a benefit of (1.75% X $30,000 x 25)/25 or $525, offset by (.75% X $30,000 x 25)/25 or $225. The offset, expressed as a percentage of final average compensation up to covered compensation, is $225/$30,000 or .75%. In the case of Employee B, the plan provides a benefit of (1.75% x $30,000 x 40)/40 or $525, offset by (.75% x $30,000 x 35)/40 or $196.88. The offset, expressed as a percentage of final average compensation up to covered compensation, is $196.88/$30,000 or .65627%. Although the offset for the two employees, expressed as a percentage of final average compensation up to covered compensation, is not uniform, under paragraph (c)(2)(iii)(B) of this section, the amount of the offset is deemed to be uniform for purposes of paragraph (c)(2) of this section because the lack of uniformity results merely from the fact that Plan A calculates the employee's offset only with respect to years of service up to 35 and accrues the offset fractionally over the employee's entire projected period of service to age 65.

* * * * *

(g) *Benefits attributable to employee contributions not taken into account* * * *

(2) *Uniform factor* * * *

(vii) *Alternative uniform factors.* A plan that satisfies the minimum benefit method for determining the portion of an employee's benefit attributable to employee contributions specified in §1.401(a)(4)–6(b)(3) may use a uniform factor of .4 for a final average compensation formula or may use a uniform factor of .6 for a career average formula in applying the rules of this paragraph (g).

* * * * *

(l) *Effective dates and transitional rules* * * *

(5) *Collectively bargained plans* * * *

(iv) Whether a plan is maintained pursuant to a collective bargaining agreement is determined under the principles applied under section 1017(c) of the Employee Retirement Income Security Act of 1974. See H.R. Rep. No. 1280, 93d Cong., 2d Sess. 266 (1974). In addition, a plan is not treated as maintained under a

collective bargaining agreement unless the employee representatives satisfy section 7701(a)(46) of the Internal Revenue Code after March 31, 1984. See §301.7701-17T for other requirements for a plan to be considered to be collectively bargained. In the case of a collectively bargained plan described in paragraph (l)(5)(i) of this section, if the date in paragraph (l)(5)(i)(B) of this section precedes November 15, 1988, then the date in this paragraph (l)(5) shall be replaced with the date on which the last of any collective bargaining agreements in effect on November 15, 1988 terminates, provided that the plan complies during this period with a reasonable good faith interpretation of section 401(l).

* * * * *

(7) *Special rule*—(i) *In general.* A plan that satisfies the requirements of paragraph (l)(7)(iii) of this section will not fail to satisfy the requirements of paragraph (l)(3) of this section merely because, for purposes of applying paragraph (l)(3)(i)(B)(*1*) of this section, the plan uses the adjusted accrued benefit calculated under paragraph (l)(7)(ii) of this section.

(ii) *Calculation of adjusted accrued benefit*—(A) *General rule.* As of any plan year beginning after December 31, 1988, an employee's adjusted accrued benefit is calculated by determining the employee's frozen accrued benefit under paragraph (l)(7)(ii)(B) of this section and adjusting that frozen accrued benefit as required under paragraph (l)(7)(ii)(C) and (D) of this section.

(B) *Frozen accrued benefit.* For purposes of this paragraph (l)(7), the term "frozen accrued benefit" means an employee's accrued benefit under the plan as in effect on November 15, 1988, determined as of the close of the last plan year beginning before January 1, 1989, as if the employee terminated employment with the employer on that determination date, and without regard to any amendment made to the plan after November 15, 1988.

(C) *Minimum benefit adjustment.* In the case of an excess plan, each employee's frozen accrued benefit is adjusted so that the base benefit percentage is not less than 50 percent of the excess benefit percentage. In the case of an offset plan, each employee's offset applied to determine the frozen accrued benefit is adjusted so that it does not exceed 50 percent of the benefit determined without regard to application of the offset.

(D) *Final pay adjustment—(1) General rule.* After the employee's frozen accrued benefit is adjusted in accordance with paragraph (l)(7)(ii)(C) of this section, it is multiplied by a fraction (not less than one), the numerator of which is the employee's average annual compensation (subject to section 401(a)(17), determined as of the current plan year and using the same definition as used to determine the frozen accrued benefit, and the denominator of which is the employee's average annual compensation determined as if the employee terminated employment as of the close of the last plan year beginning before January 1, 1989, and without regard to any amendment made after that date.

(*2*) *Special rules.* In lieu of the adjustment described in paragraph (l)(7)(ii)(D)(*1*) of this section, the frozen accrued benefit for each employee under the plan may be multiplied by a uniform percentage (not to exceed 100%) of the fraction determined for the employee as described above. A plan will not fail to meet the requirements of this paragraph (l)(7)(ii)(D) merely because the plan imposes a uniform maximum dollar amount on the adjusted accrued benefit for all employees.

(iii) *Requirements.* The plan must satisfy the following requirements—

(A) As of November 15, 1988, and without regard to any plan amendments made after that date, the plan contained a benefit formula under which the portion of an employee's accrued benefit at retirement that is attributable to the employee's period of service as of the close of the last plan year beginning before January 1, 1989, would be determined with reference to compensation earned by the employee in years beginning after December 31, 1988, and

(B) For purposes of paragraph (l)(3)(i)(B)(*1*) of this section, the plan uses the adjusted accrued benefit, as calculated under paragraph (l)(7)(ii) of this section, with respect to each employee who has at least one hour of service in any plan year beginning after December 31, 1988.

(iv) *Examples.* The provisions of this paragraph (l)(7) may be illustrated by the following examples. In each example, the plan contains no benefit or feature that would require a reduction in the 1% annual disparity or the offset of 83 1/3 percent of primary insurance amount allowed under Rev. Rul. 71-446; or in the 3/4 of 1% percent annual disparity allowed under section 401(l) and the regulations thereunder. Further, in each example, the normal retirement age under the plan is 65 and each employee has a social security retirement age of 65.

Example (1). (a) Employer X maintained a defined benefit excess plan that was integrated with benefits provided under the Social Security Act. The plan year of the plan is the calendar year. As of November 15, 1988, the benefit formula under the plan provided that each employee would receive a normal retirement benefit equal to the sum of 1% of the employee's average annual compensation up to covered compensation, multiplied by the employee's years of credited service for X, plus 2% of the employee's average annual compensation in excess of the employee's covered compensation, multiplied by the employee's years of credited service for X. On November 15, 1988, the plan defined average annual compensation as the average of the employee's compensation for the 5 years (out of the employee's entire period of participation) which produced the highest average.

(b) As of December 31, 1988 (the close of the last plan year preceding the year for which section 401(l) and the regulations thereunder are effective), Employee A had 10 years of credited service for X; had covered compensation of $25,000; and had average annual compensation (as defined under the plan) of $30,000. Accordingly, as of December 31, 1988, A had an accrued normal retirement benefit of $3,500 (the sum of 10% of $25,000, plus 20% of $5,000). As of January 1, 1989, X amends the benefit formula to provide that each employee will receive a normal retirement benefit equal to the sum of 1% of the employee's average annual compensation up to covered compensation, multiplied by the employee's years of credited service for X, plus 1.75% of the employee's average annual compensation in excess of the employee's covered compensation, multiplied by the employee's years of credited service for X.

(c) The plan applies the transition rule set forth in paragraph (l)(3) of this section under which A's normal retirement benefit is determined as the sum of (1) A's accrued benefit as of December 31, 1988, under the pre-amended benefit formula and (2) A's accrued benefit attributable to years of credited service after December 31, 1988, under the amended benefit formula. Assume also that the plan does not amend its definition of average annual compensation.

(d) As of December 31, 1992, A has 14 years of credited service for X; A has covered compensation of $30,000; and A has average annual compensation of $40,000. The plan does not fail to satisfy section 401(l) and the regulations thereunder merely because the plan determines A's accrued normal retirement ben-

efit at December 31, 1992, as $6,565 (the sum of $3,500 multiplied by 133.3% (the ratio of $40,000 (A's average annual compensation as of December 31, 1992) to $30,000 (A's average annual compensation as of December 31, 1988)) plus $1,900 (4% times $30,000 plus 7% times $10,000)).

Example (2). (a) Employer Y maintained a defined benefit excess plan that is integrated with benefits provided under the Social Security Act. The plan year of the plan is the calendar year. As of November 15, 1988, the benefit formula under the plan provided that each employee would receive a normal retirement benefit equal to 1% of the employee's average annual compensation in excess of the employee's covered compensation, multiplied by the employee's years of credited service for Y. The plan provided no benefit with respect to average annual compensation up to covered compensation. On December 31, 1987, the plan defined average annual compensation as the average of the employee's compensation for the 5 years (out of the employee's entire period of participation) which produced the highest average.

(b) As of December 31, 1988 (the close of the last plan year preceding the year for which section 401(l) and the regulations thereunder are effective), Employee A had 10 years of credited service for Y; had covered compensation of $25,000; and had average annual compensation (as defined under the plan) of $20,000. A's average annual compensation had never exceeded $20,000. Accordingly, as of December 31, 1988, A had no accrued normal retirement benefit under the plan. As of January 1, 1989, Y amends the benefit formula to provide that each employee will receive a normal retirement benefit equal to the sum of .6% of the employee's average annual compensation up to covered compensation, multiplied by the employee's years of credited service for Y, plus 1.2% of the employee's average annual compensation in excess of the employee's covered compensation, multiplied by the employee's years of credited service for Y.

(c) The plan applies the transition rule set forth in paragraph (l)(3) of this section under which A's normal retirement benefit is determined as the sum of (1) A's accrued benefit as of December 31, 1988, under the pre-amended benefit formula and (2) A's accrued benefit attributable to years of credited service after December 31, 1988, under the amended benefit formula. Assume also that the plan does not amend its definition of average annual compensation.

(d) As of December 31, 1992, A has 14 years of credited service for Y; A has covered compensation of $30,000; and A has average annual compensation of $35,000. Because the excess benefit percentage under the plan before it was amended effective January 1, 1989, had been 1%, the plan provides that A's accrued normal retirement benefit as of December 31, 1988, attributable to years of credited service before January 1, 1989, will equal the normal retirement benefit A would have accrued if the base benefit percentage had been .5%. Accordingly, the plan provides that A's accrued normal retirement benefit as of December 31, 1988, is $1,000 (.5% times 10 years times $20,000).

(e) The plan does not fail to satisfy section 401(l) and the regulations thereunder merely because the plan determines A's normal retirement benefit as of December 31, 1992, as $2,710 (the sum of $1,750 ($1,000 multiplied by 175% (the ratio of $35,000 (A's average annual compensation as of December 31, 1992) to $20,000 (A's average annual compensation as of December 31, 1988))) plus $960 (2.4% times $30,000 plus 4.8% times $5,000)).

Example (3). (a) Employer Z maintained a defined benefit offset plan that was integrated with benefits provided under the Social Security Act. The plan year of the plan is the calendar year. As of November 15, 1988, the benefit formula under the plan provided that each employee would receive a normal retirement benefit equal to 50% of the employee's average annual compensation, reduced or offset by 83 1/3% of the employee's projected primary insurance amount under the Social Security Act. The plan used the fractional rule for purposes of determining both the positive portion of the employee's benefit and the offset applied to the employee's benefit. On November 15, 1988, the plan defined average annual compensation as the average of the employee's compensation for the 5 years (out of the employee's entire period of participation) which produced the highest average.

(b) As of December 31, 1988 (the close of the last plan year preceding the year for which section 401(l) and the regulations thereunder are effective), Employee A, who was hired at age 40, had 10 years of credited service for Z; had a projected annual primary insurance amount of $10,000; had covered compensation of $25,000; and had average annual compensation (as defined under the plan) of $30,000. Accordingly, as of December 31, 1988, A had an accrued normal retirement benefit of $2,667 ($6,000 ($15,000 times 10/25) minus $3,333 (83 1/3% of $10,000 times 10/25)). As of January 1, 1989, Z amends the benefit formula to provide that for each year of credited service after December 31, 1988, each employee will receive a normal retirement benefit equal to 2% of the employee's average annual compensation offset by 3/4 of 1% of the employee's final average compensation up to covered compensation.

(c) The plan applies the transition rule set forth in §1.401(l)-3(l)(3) under which A's normal retirement benefit is determined as the sum of (1) A's accrued benefit as of December 31, 1988, under the pre-amended benefit formula and (2) A's accrued benefit attributable to years of credited service after December 31, 1988, under the amended benefit formula. Assume also that the plan does not amend its definition of average annual compensation.

(d) As of December 31, 1992, A has 14 years of credited service for Z; A has covered compensation of $30,000; and A has average annual compensation and final average compensation of $40,000. Because the positive portion of A's benefit under the plan ($6,000) before it was amended effective January 1, 1989, had been reduced or offset ($3,333) by more than 50%, the plan provides that A's accrued normal retirement benefit as of December 31, 1988, attributable to years of credited service before January 1, 1989, will equal the normal retirement benefit A would have accrued if A's benefit had been reduced only by 50%. Accordingly, the plan provides that A's accrued normal retirement benefit as of December 31, 1988, is $3,000 ($6,000 minus $3,000). The plan does not fail to satisfy section 401(l) and the regulations thereunder merely because the plan determines A's normal retirement benefit as of December 31, 1992, as $6,300 (the sum of $4,000 ($3,000 multiplied by 133.3% (the ratio of $40,000 (A's average annual compensation as of December 31, 1992) to $30,000 (A's average annual compensation as of December 31, 1988))) plus $2,300 (8% times $40,000 minus 3% times $30,000)).

* * * * *

Par. 6. Section 1.401(l)-4, as proposed on November 15, 1988 (53 FR 45917), is amended by adding a new sentence at the end of paragraph (a)(1) to read as follows:

§1.401(l)-4 Combining and aggregating plans.

(a) *Overall permitted disparity*—(1) *In general.* * * * A plan does not fail to satisfy the requirements of this section merely because the plan contains two or more formulas as described in paragraph (b)(2)(iii)(C) or (c)(2)(iii)(C) of §1.401(l)-3, provided the disparity utilized in each formula does not exceed the maximum disparity permitted under §1.401(l)-3(b)(6) or (c)(5) with respect to that formula.

* * * * *

Par. 7. Section 1.401(m)-1 as proposed on August 8, 1988 (53 FR 29719) is amended by revising paragraph (e)(4)(iii), the penultimate sentence of the concluding text of paragraph (f)(8), and paragraph (f)(13)(iii)(A) to read as follows:

§1.401(m)-1 Employee contributions and matching contributions.

* * * * *

(e) *Correction of excess aggregate contributions* * * *

(4) *Special rules* * * *

(iii) *Correction of family members.* The determination and correction of excess aggregate contributions of a highly compensated employee whose actual contribution ratio is determined under the family aggregation rules of paragraph (f)(13) of this section is accomplished by reducing the actual contribution ratio as required under paragraph (e)(2) of this section and allocating the excess aggregate contributions for the family group among the family members in proportion to the employee contributions and matching contributions of each family member that are combined to determine the actual contribution ratio.

* * * * *

(f) *Definitions* * * *

(8) *Matching contribution* * * *

(i) * * *

* * * Notwithstanding the foregoing, for plan years beginning before January 1, 1992, an employer may elect to take into account as matching contributions, contributions made to a plan pursuant to an arrangement under which the employer makes contributions to the plan on account of either employee contributions to the plan or contributions made by an employee to an employer-sponsored savings arrangement that are not held in the plan, provided that the arrangement was in effect prior to August 8, 1988.

* * *

* * * * *

(13) *Actual contribution percentage*

* * *

(iii) *Aggregation of family members*—(A) For plan years beginning after December 31, 1986, or any later date provided in paragraph (h) of this section, if an eligible highly compensated employee is subject to the family aggregation rules of section 414(q)(6) because that employee is either a five percent owner or one of the ten most highly compensated employees, the combined actual contribution ratio for the family group (which is treated as one highly compensated employee) must be determined by combining the employee contributions, compensation, matching contributions and amounts treated as matching contributions of all the eligible family members.

(B) * * *

* * * * *

Par. 8. Section 1.401(m)-2, as proposed on August 8, 1988 (53 FR 29719), is amended as follows:

1. In paragraph (b)(1), the introductory text is revised and new paragraphs (b)(1)(iii) and (b)(1)(iv) are added before the concluding text that follows paragraph (b)(1)(ii), to read as set forth below.

2. Paragraph (b)(3)(i) is revised to read as set forth below.

3. Paragraph (b)(3)(ii) is redesignated as paragraph (b)(3)(iii), items (1) through (5) of Example 1 in newly designated paragraph (b)(3)(iii) are revised to read as set forth below, and Example 3 is added following Example 2 to read as set forth below.

4. A new paragraph (b)(3)(ii) is added as set forth below.

5. In paragraph (c)(4), steps 1 and 2 in Example 1 are revised to read as set forth below.

§1.401(m)-2 Multiple use of alternative limitation.

* * * * *

(b) *General rule for determination of multiple use*—(1) *In general.* Multiple use of the alternative limitation occurs if all of the conditions of this paragraph (b)(1) are satisfied:

(i) * * *

(ii) * * *

(iii) The actual deferral per-centage of the entire group of eligible highly compensated employees under the arrangement subject to section 401(k) exceeds the amount described in section 401(k)(3)(A)(ii)(I).

(iv) The actual contribution percentage of the entire group of eligible highly compensated employees under the arrangement subject to section 401(m) exceeds the amount described in section 401(m)(2)(A)(i).

* * * * *

(3) *Aggregate limit*—(i) *In general.* For purposes of this section, the aggregate limit is the greater of:

(A) The sum of:

(*1*) 1.25 times the greater of the relevant actual deferral percentage or the relevant actual contribution percentage, and

(*2*) Two percentage points plus the lesser of the relevant actual deferral percentage or the relevant actual contribution percentage. In no event, however, shall this amount exceed twice the lesser of the relevant actual deferral percentage or the relevant actual contribution percentage; or

(B) The sum of:

(*1*) 1.25 times the lesser of the relevant actual deferral percentage or the relevant actual contribution percentage, and

(*2*) Two percentage points plus the greater of the relevant actual deferral percentage or the relevant actual contribution percentage. In no event, however, shall this amount exceed twice the greater of the relevant actual deferral percentage or the relevant actual contribution percentage.

(ii) *Relevant actual deferral percentage and relevant actual contribution percentage defined.* For purposes of paragraph (b)(3)(i) of this section, the term "relevant actual deferral percentage" means the actual deferral percentage of the group of non-highly compensated employees eligible under the arrangement subject to section 401(k) for the plan year, and the term "relevant actual contribution percentage" means the actual contribution percentage of the group of nonhighly compensated employees eligible under the plan subject to section 401(m) for the plan year beginning with or within the plan year of the arrangement subject to section 401(k).

(iii) *Examples.* * * *

Example 1. * * *

(1)	Greater of the relevant actual deferral percentage or the relevant actual contribution percentage	4.0
(2)	1.25 times (1)	5.0
(3)	Lesser of the relevant actual deferral percentage or the relevant actual contribution percentage	3.0
(4)	(3) plus two percentage points	5.0
(5)	(2) + (4)	10.0
(6)	1.25 times (3)	3.75
(7)	(1) plus two percentage points	6.0
(8)	(6) + (7)	9.75
(9)	Aggregate limit Greater of (5) or (8)	10.0

* * * * *

Example 2. * * *

Example 3. Employer E maintains a plan that contains a cash or deferred arrangement and provides for matching contributions. The actual deferral and contribution percentages for a plan year are as follows:

	Actual Deferral Percentage	Actual Contribution Percentage
Highly compensated	3.6	1.69
Nonhighly compensated	1.8	1.35

The actual deferral percentage of the highly compensated employees exceeds the normal limit (1.25 times 1.8, or 2.25 percent) but not the alternative limit (2 plus 1.8, but not more than twice 1.8, or 3.6 percent). The actual contribution percentage of the highly compensated employees does not exceed the normal limit (1.25 times 1.35, or 1.69 percent). Accordingly, the plan satisfies both the actual deferral and contribution percentage tests. Since the actual contribution percentage of the highly compensated employees does not exceed the normal limit, condition (iv) of paragraph (b)(1) of this section is not satisfied. Therefore, there is no multiple use of the alternative limitation.

(c) *Correction of multiple use* * * *

(4) Examples * * *

Example (1) * * *

Step 1: Determination of aggregate limit.

(1)	Greater of relevant actual deferral percentage or relevant actual contribution percentage	4.0
(2)	1.25 times (1)	5.0
(3)	Lesser of relevant actual deferral percentage or relevant actual contribution percentage	4.0
(4)	(3) plus two percentage points	6.0
(5)	(2) + (4)	11.0

(6)	1.25 times (3)	5.0
(7)	(1) plus two percentage points	6.0
(8)	(6) + (7)	11.0
(9)	Aggregate limit Greater of (5) or (8)	11.0
	Step 2: Calculation of correction amount.	
(10)	Actual deferral percentage of highly compensated	6.0
(11)	Maximum permitted actual contribution percentage of highly compensated ((9)–(10))	5.0
(12)	Amount taken into account in determining actual contribution percentage of highly compensated employee X	$6,000
(13)	Maximum amount permitted without use of alternative limitation ((11) X compensation of employee X)	$5,000
(14)	Excess aggregate contribution ((12)–(13))	$1,000

* * * * *

Par. 9. Section 1.410(b)–2 as proposed on May 18, 1989 (54 FR 21437), is amended by revising paragraphs (b)(1) and (b)(6), adding paragraphs (b)(7) and (b)(8), and revising paragraph (c)(2)(ii)(B) to read as follows:

§1.410(b)–2 Minimum coverage requirements (after 1988).

* * * * *

(b) *Requirements with respect to active employees*—(1) *In general.* A plan satisfies this paragraph (b) for a plan year only if it satisfies at least one of the following paragraphs (b)(2) through (b)(8) of this section for that year.

* * * * *

(6) *Certain governmental plans.* For plan years beginning on or after January 1, 1993, a plan satisfies this paragraph (b)(6) for a plan year only if it is described in section 410(c)(1)(A) and satisfies section 401(a)(3) as in effect on September 1, 1974. For plan years beginning before January 1, 1993, any plan described in section 410(c)(1)(A) satisfies this paragraph (b)(6).

(7) *Certain section 403(b) plans.* For plan years beginning on or after January 1, 1993, a plan subject to section 403(b)(12) satisfies this paragraph (b)(7) for a plan year only if, with respect to contributions not made pursuant to a salary reduction agreement, the plan satisfies section 410(b) without regard to section 410(c) and paragraphs (b)(6) and (b)(8) of this section. For plan years beginning before January 1, 1993, a plan subject to the requirements of section 403(b)(12) that is maintained by an employer described in section 414(d) satisfies this paragraph (b)(7).

(8) *Certain church plans, etc.* A plan satisfies this paragraph (b)(8) for a plan year only if it is described in section 410(c)(1)(B), (C), or (D) and satisfies section 401(a)(3) as in effect on September 1, 1974.

(c) *Requirements with respect to former employees* * * *

(2) *Application of section 410(b) to former employees* * * *

(ii) *Testing former employees* * * *

(B) *Special rule.* A plan is deemed to satisfy paragraph (b) of this section with respect to its former employees with a current benefit if at least five former employees are currently benefiting under the plan and at least 60 percent of the former employees who are currently benefiting under the plan are not highly compensated former employees.

* * * * *

Par. 10. Section 1.410(b)–6 as proposed on May 18, 1989 (54 FR 21437), is amended by revising paragraphs (b)(1) and (b)(2) to read as follows:

§1.410(b)-6 Excludable employees.

* * * * *

(b) *Minimum age and service exclusions*—(1) *In general.* If a plan applies minimum age and service eligibility conditions permissible under section 410(a)(1) and excludes all active employees who do not meet those conditions from benefiting under the plan, then all active employees who fail to satisfy those conditions may be treated as excludable employees with respect to that plan.

(2) *Plans benefiting otherwise excludable employees*—(i) *In general.* Employees who would be excludable under paragraph (b)(1) of this section (without regard to section 410(a)(1)(B)) but for the fact that the plan does not apply the greatest permissible minimum age and service conditions may be treated as excludable employees with respect to the plan. This treatment is available only if the plan satisfies section 410(b) and §1.410(b)–2 with respect to the otherwise excludable employees in the manner described in paragraph (b)(2)(ii) of this section. For purposes of applying section 410(b), in that case, the plan may be treated as two separate plans, one for the otherwise excludable employees and one for the other employees covered by the plan.

(ii) *Testing otherwise excludable employees.* In determining whether the plan (or portion of a plan that is treated as a separate plan) that benefits active employees who would otherwise be excludable under paragraph (b)(1) of this section (without regard to section 410(a)(1)(B)) satisfies section 410(b) and §1.410(b)–2, active employees who have satisfied the greatest permissible minimum age and service conditions with respect to the plan are disregarded. In addition, if the plan (or portion thereof) being tested applies minimum age and service conditions and those conditions are less than the maximum permissible minimum age and service conditions, active employees who have not satisfied the lower minimum age and service conditions actually provided for in the plan may be treated as excludable employees. Thus, for example, if the plan requires attainment of age 18 and 3 months of service, employees who have not attained age 18 or 3 months of service with the employer may be excluded.

* * * * *

Par. 11. Section 1.410(b)–9(g) as proposed on May 18, 1989 (54 FR 21437), is revised to read as follows:

§1.410(b)–9 Definitions.

* * * * *

(g) *Professional.* The term "professional" means any highly compensated employee who, on any day of the plan year, performs professional services for the employer as a certified or other public accountant, actuary, architect, attorney, chiropodist, chiropractor, executive, investment banker, medical doctor, dentist, optometrist, osteopath, podiatrist, engineer, psychologist, stockbroker, or veterinarian, or in any other professional capacity determined by the Commissioner in a notice or other document of general applicability to constitute the performance of services as a professional.

Fred T. Goldberg, Jr.,
Commissioner of
Internal Revenue

(Filed by the Office of the Federal Register on May 10, 1990, 8:45 a.m., and published in the issue of the Federal Register for May 14, 1990, 55 F.R. 19947)

Notice of Proposed Rulemaking

Treatment of Certain Losses Attributable to Periods After October 31 of a Taxable Year of a Regulated Investment Company

FI-105-88

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In *** [T.D. 8287, page 130, this Bulletin], the Internal Revenue Service is issuing temporary regulations relating to the treatment by a regulated investment company of a net capital loss, a net long-term capital loss, or of a net foreign currency loss attributable to periods after October 31 of a taxable year. The text of the temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: The regulations are proposed to be effective for, and be applicable to, taxable years of regulated investment companies ending after October 31, 1987. Written comments and requests for a public hearing must be delivered by April 2, 1990.

ADDRESS: Send comments and requests for a public hearing to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Attention: CC:CORP:T (FI-105-88), Washington, D.C. 20044.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1980 (44 U.S.C. 3504(h)). Comments on the collections of information should be sent to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503, with copies to the Internal Revenue Service, Attention: IRS Reports Clearance Officer, T:FP, Washington, D.C. 20224.

The collections of information in this regulation are in section 26 CFR 1.852-11T. This information is required by the Internal Revenue Service to effect an election provided by section 1.852-11T. This information will be used to verify that the appropriate amounts are included in taxable income for the proper taxable year. The likely respondents are businesses or other for-profit institutions.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents may require greater or less time, depending on their particular circumstances.

Estimated total annual reporting burden: 69 hours.

The estimated annual burden per respondent varies from 10 minutes to 20 minutes, depending on individual circumstances, with an estimated average of 15 minutes.

Estimated number of respondents: 275.

Estimated frequency of responses: annually.

Background

The temporary regulations in *** [T.D. 8287, page 130, this Bulletin] amend the Income Tax Regulations (26 CFR Part 1) under section 852 of the Internal Revenue Code of 1986 to reflect certain amendments made to the Code by the Tax Reform Act of 1986 (Pub. L. 99-514; 100 Stat. 2085) [1986-3 C.B. (Vol. 1) 1] and by the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. 100-647; 102 Stat. 3342). The temporary regulations are designated by a "T" following their section citation. The final regulations which are proposed to be based on the temporary regulations would amend Part 1 of Title 26 of the Code of Federal Regulations. The regulations provide rules relating to the treatment by a regulated investment company of a net capital loss, a net long-term capital loss, or a net foreign currency loss attributable to periods after October 31 of a taxable year for purposes of determining taxable income, earnings and profits, and the amount which may be designated as capital gain dividends for a taxable year.

For the text of the temporary regulations see T.D. 8287, in *** [page 130, this Bulletin]. The preamble to the temporary regulations provides a discussion of the rules.

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Request for a Public Hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably an original and eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

List of Subjects

26 CFR Part 1.851-1—1.860-1

Income taxes, Investment companies, Real estate investment trusts.

26 CFR Part 602

Reporting and recordkeeping requirements.

Charles H. Brennan,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 30, 1990, 8:45 a.m., and published in the issue of the Federal Register for January 31, 1990, 55 F.R. 3231)

Notice of Proposed Rulemaking

Price Level Adjusted Mortgages

FI-64-89

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In *** [T.D. 8281, page 37, this Bulletin], the Internal Revenue Service is issuing temporary regulations that provide rules for the treatment of price level adjusted mortgages ("PLAMs") under the original issue discount and qualified residence interest provisions of the Internal Revenue Code of 1986. In addition, the temporary regulations provide rules for the treatment of payments received pursuant to a PLAM for purposes of the information reporting of home mortgage interest. The text of the temporary regulations also serves as the comment document for this notice of proposed rulemaking.

EFFECTIVE DATES: Section 1.163-11T is proposed to be effective for tax years beginning after December 31, 1987. Sections 1.1275-6T and 1.6050H-2T are proposed to be effective for price level adjusted mortgages issued after January 8, 1990. Written comments and requests for a public hearing must be delivered or mailed by April 9, 1990.

ADDRESS: Send comments and requests for a public hearing to: Internal Revenue Service, Attn: CC: CORP:T:R (FI-64-89), Room 4429, Washington, D.C. 20224.

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations in *** [T.D. 8281, page 37, this Bulletin], add new temporary regulation §1.163-11T, new temporary regulation §1.1275-6T, and new temporary regulation §1.6050H-2T to Part 1 of Title 26 of the CFR. The temporary regulations provide rules for the tax treatment of a PLAM under section 163(h), which deals with the disallowance of deductions for personal interest (§1.163-11T), and the original issue discount provisions of the Code (§1.1275-6T). The temporary regulations also provide rules for the treatment of payments received pursuant to a PLAM under section 6050H, which deals with information reporting of mortgage interest (§1.6050H-2T). For the text of the new temporary regulations, see T.D. 8281, published in *** [page 37, this Bulletin]. The preamble to the temporary regulations explains the regulations.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted, consideration will be given to any written comments that are submitted (preferably a signed original and seven copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Internal Revenue Service by any person who also submits written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 8, 1990, 8:45 a.m., and published in the issue of the Federal Register for January 9, 1990, 55 F.R. 739)

Notice of Proposed Rulemaking

Yield Adjustment Payments for Qualified Student Loan Bonds

FI-75-89

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In *** [T.D. 8285, page 26, this Bulletin], the Internal Revenue Service is issuing temporary regulations to allow certain yield adjustment payments with respect to excess earnings on acquired purpose obligations acquired with proceeds of qualified student loan bonds. The text of the temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered by March 26, 1990. The amendment is proposed to be effective for qualified student loan bonds issued after January 5, 1990.

ADDRESS: Send comments and requests for a public hearing to: Internal Revenue Service, P. O. Box 7604, Ben Franklin Station, Attention: CC: CORP:T:R (FI-75-89), Room 4429, Washington, D.C. 20044.

SUPPLEMENTARY INFORMATION

Background

The temporary regulations published in *** [T.D. 8285, page 26, this Bulletin] add new §1.148-10T to Part 1 of Title 26 of the Code of Federal Regulations. The new temporary regulations provide rules concerning the computation and payment of excess earnings to the United States with respect to certain qualified student loan bonds. The text of the new temporary regulations serves as the comment document for this notice of proposed rulemaking. In addition, the preamble to the temporary regulations provides a discussion of the proposed and temporary rules.

For the text of the temporary regulations, see T.D. 8285 published in *** [page 26, this Bulletin].

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

Before the adoption of these proposed regulations, consideration will be given to any written comments that are submitted (preferably a signed original and eight copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Internal Revenue Service by any person who also submits written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

List of Subjects

29 CFR 1.61—1.281-4

Income taxes, Taxable Income, Deductions, Exemptions.

Proposed Amendments to the Regulations

The temporary regulations, T.D. 8285, published in *** [page 26, this Bulletin] are hereby also proposed as final regulations under section 148 of the Internal Revenue Code.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 22, 1990, 2:36 p.m., and published in the issue of the Federal Register for January 25, 1990, 55 F.R. 2534)

Notice of Proposed Rulemaking

Treatment of Salvage and Reinsurance Under Section 832(b)

FI-76-89

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In *** [T.D. 8293, page 123, this Bulletin], the Internal Revenue Service is issuing temporary regulations relating to the treatment of salvage and reinsurance in determining the paid and unpaid losses of property and casualty insurance companies. The text of the temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered by May 14, 1990. The amendments to §1.832-4T of the regulations are proposed to be effective for taxable years beginning after December 31, 1989. Section 1.832-7T is proposed to be effective for taxable years beginning before January 1, 1990.

ADDRESS: Send comments and requests for a public hearing to: Internal Revenue Service, Attn: CC: CORP:T:R (FI-76-89), P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044.

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations published in *** [T.D. 8293, page 123, this Bulletin] amend temporary regulations §1.832-4T and §1.832-7T of Part 1 of Title 26 of the Code of Federal Regulations. The amended temporary regulations provide rules relating to the treatment of salvage and reinsurance under section 832(b)(5) of the Internal Revenue Code. Accordingly, the text of the amended temporary regulations serves as the comment document for this notice of proposed rulemaking. In addition, the preamble to the temporary regulations provides a discussion of the proposed and temporary rules.

For the text of the temporary regulations, see T.D. 8293 *** [page 123, this Bulletin].

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C.Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Internal Revenue Service by any person who submits written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on March 13, 1990, 8:45 a.m., and published in the issue of the Federal Register for March 14, 1990, 55 F.R. 9464)

Notice of Proposed Rulemaking

Time and Place of Examination

GL-705-88

AGENCY: Internal Revenue Service, Treasury

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In *** [T.D. 8297, page 190, this Bulletin], the Internal Revenue Service is issuing temporary regulations relating to the time and place of examination. The text of the temporary regulations also serves as a comment document for this notice of proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed by May 18, 1990.

ADDRESSES: Send comments and requests for a public hearing to: Internal Revenue Service, Attn: CC: CORP:T:R (GL-705-88), Room 4429, Washington, D.C. 20224

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations in *** [T.D. 8297, page 190, this Bulletin] amend the Procedure and Administration Regulations (26 CFR Part 301) pursuant to section 7605(a) of the Internal Revenue Code. For the text of the regulations see T.D. 8297 published in *** [page 190, this Bulletin]. The preamble to the temporary regulations explains the regulations.

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Request for a Public Hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably a signed original and seven copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Internal Revenue Service by any person who submits written comments. If a public hearing is to be held, notice of time and place will be published in the Federal Register.

List of Subjects in 26 CFR Part 301

Administrative practice and procedure, Bankruptcy, Courts, Crime, Disclosure of information, Employment taxes, Estate tax, Excise taxes, Filing requirements, Gift tax, Income taxes, Investigations, Law enforcement, Penalties, Pensions, Statistics, Taxes.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on April 2, 1990, 8:45 a.m., and published in the issue of the Federal Register for April 3, 1990, 55 F.R. 12386)

Notice of Proposed Rulemaking

Like-kind Exchanges—Limitations on Deferred Exchanges; and Inapplicability of Section 1031 to Exchanges of Partnership Interests

IA-237-84

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that add new §1.1031(a)-3 relating to limitations on deferred exchanges and amend §1.1031(a)-1 relating to the general requirements for exchanges under section 1031 of the Internal Revenue Code of 1986, as amended. Changes to the applicable law were made by section 77 of the Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494, 595-97 (the "Act") [1984-3 C.B. (Vol. 1) 1, 103]. A technical correction was made by section 1805(d) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, 2810 [1986-3 C.B. (Vol. 1) 1, 727]. The regulations will provide the public with the guidance needed to comply with section 77 of the Act.

DATES: Section 1.1031(a)-3 is proposed to be effective for transfers of property made by the taxpayer after July 2, 1990, subject to an exception for certain binding contracts. The amendments to §1.1031(a)-1 are proposed to be effective for transfers of property made by the taxpayer after July 18, 1984, subject to an exception for certain binding contracts. Written comments and/or requests to appear (with an outline of the oral comments to be presented) at a public hearing scheduled for September 5 and 6, 1990, at 10:00 a.m., must be received by July 27, 1990.

ADDRESS: Send comments and requests to appear at the public hearing to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Room 4429, Washington, D.C. 20044 (Attn: CC:CORP:T:R (IA-237-84)). The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Ave., N.W., Washington, D.C.

SUPPLEMENTARY INFORMATION:

Background

An exchange of property, like a sale, generally results in the current recognition of gain or loss. Section 1031(a) provides an exception to this general rule. Under section 1031(a), no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a like kind that is to be held either for productive use in a trade or business or for investment. Section 1031(a) specifically does not apply to exchanges of stock in trade or other property held primarily for sale, stocks, bonds, notes, other securities or evidences of indebtedness or interest, certificates of trust or beneficial interests, or choses in action.

Prior to revision by the Act, it was unclear to what extent exchanges of interests in a partnership were excluded from the nonrecognition provisions of section 1031. Compare Rev. Rul. 78-135, 1978-1 C.B. 256, with *Estate of Meyer v. Commissioner*, 58 T.C. 311 (1972), *nonacq.*, 1975-1 C.B. 3, *aff'd per curium*, 503 F.2d 556 (9th Cir. 1974).

Prior to revision by the Act, section 1031 also did not specifically require that a like-kind exchange be completed within a specified period in order to qualify for nonrecognition of gain or loss. For example, in *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979), the Ninth Circuit held that an exchange qualified for nonrecognition of gain or loss under section 1031 even though the property to be received by the taxpayer could be designated up to 5 years after the initial transfer of property by the taxpayer and even though the taxpayer could have ultimately received cash rather than like-kind property.

Section 77 of the Act clarified the application of section 1031 in the case of nonsimultaneous or deferred exchanges by providing specific time limits for the identification and receipt of the replacement property. In addition, this section of the Act specifically provided that section 1031(a) does not apply to any exchange of interests in a partnership.

This document contains proposed amendments and additions to the Income Tax Regulations under section 1031 of the Internal Revenue Code. These proposed amendments and additions provide guidance with respect to the amendments to section 1031 that were enacted by section 77 of the Act.

Explanation of provisions

DEFERRED EXCHANGES

In General

Section 1031(a)(3) was added by section 77 of the Act. Section 1031(a)(3) provides that any property received by the taxpayer in a deferred exchange is treated as property which is not like-kind property if (a) such property is not identified as property to be received in the exchange on or before the day which is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or (b) such property is received after the earlier of (1) the day which is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange, or (2) the due date (including extensions) of the taxpayer's tax return for the taxable year in which the transfer of the relinquished property occurs.

This provision was enacted due to concern that without such restrictions the application of section 1031 to deferred exchanges would give rise to unintended results and to administrative problems. For example, the nonrecognition rules applicable to like-kind exchanges have been justified on the grounds that a taxpayer making a like-kind exchange has not changed its investment and thus a realization event resulting in the recognition of gain or loss should not be considered to have occurred. This rationale for section 1031 is less applicable in the case of deferred exchanges. To the extent the taxpayer is able to defer completion of the transaction and retains the right to designate the property to be received at some future point, the transaction resembles a sale more than an exchange. In other words, the greater the taxpayer's discretion to vary the particular property to be received in exchange for the relinquished property and to vary the date on which such replacement property (or money) is to be received, the more the transaction is appropriately treated as a sale and not as a like-kind exchange.

Although section 1031(a)(3) is limited to the identification and receipt requirements of a deferred exchange, other issues important to the application of section 1031 to deferred exchanges require clarification. In particular, the use of various security arrangements, guarantees, and intermediaries in deferred exchanges raise questions concerning the definition of a deferred exchange and concerning how the rules of actual or constructive receipt apply in the case of a deferred exchange. Questions have also been raised concerning the computation of gain or loss recognized and the basis of property received in a deferred exchange.

Thus, new §1.1031(a)-3 is added to the regulations under section 1031 to provide guidance with respect to the following: (a) the definition of a deferred exchange; (b) the identification and receipt requirements of section 1031(a)(3); (c) the receipt of money or other property in the case of a deferred exchange; and (d) the computation of gain or loss recognized and the basis of property received in a deferred exchange.

Definition of Deferred Exchange

The proposed regulations define a deferred exchange as an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the "relinquished property") and subsequently receives property to be held either for productive use in a trade or business or for investment (the "replacement property"). In order to constitute a deferred exchange, the transaction must be an exchange (i.e., a transfer of property for property, as distinguished from a transfer of property for money). For example, a sale of property followed by a purchase of property of a like kind to the property sold does not qualify for nonrecognition of gain or loss under section 1031 regardless of whether the other requirements of section 1031 are satisfied.

The proposed regulations do not apply if the taxpayer receives the replacement property prior to the date on which the taxpayer transfers the relinquished property. Comments are requested concerning whether section 1031 applies to such transactions.

Identification and Receipt Requirements

The proposed regulations provide that, in the case of a deferred exchange, any replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property if (a) the replacement property is not "identified" before the end of the "identification period," or (b) the identified replacement property is not received before the end of the "exchange period." This general rule follows directly from the provisions of section 1031(a)(3). The identification period begins on the date the taxpayer transfers the relinquished property and ends 45 days thereafter. The exchange period begins on the date the taxpayer transfers the relinquished property and ends on the earlier of 180 days thereafter or the due date (including extensions) for the taxpayer's tax return for the taxable year in which the transfer of the relinquished property occurs.

As noted above, the greater the taxpayer's discretion to vary the particular property to be received in exchange for the relinquished property after the transfer of the relinquished property, the more the transaction appears to be a sale rather than an exchange. The policy underlying the identification requirement is

thus to retain the exchange character of the transaction by requiring taxpayers to identify the replacement property by the end of the identification period. This purpose is best served by requiring the identification of the replacement property to be as specific as possible.

The proposed regulations provide rules for determining whether, in the case of a deferred exchange, the taxpayer has identified replacement property before the end of the identification period. These rules are intended to balance the underlying policy of the exchange requirement with the difficulties taxpayers may face in trying to specifically identify the particular replacement property to be received in the exchange within the identification period.

Under the proposed regulations, replacement property is treated as identified for purposes of section 1031(a)(3) only if it is designated as replacement property in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or otherwise sent before the end of the identification period to a person involved in the exchange other than the taxpayer or a related party. The identification may also be made in a written agreement for the exchange of properties. The replacement property must be unambiguously described in the written document or agreement. For example, real property generally is unambiguously described if it is described by a legal description or street address.

The taxpayer may identify more than 1 property as replacement property. However, regardless of the number of relinquished properties transferred by the taxpayer as part of the same deferred exchange, the maximum number of replacement properties that the taxpayer may identify is (a) 3 properties of any fair market value, or (b) any number of properties as long as their aggregate fair market value as of the end of the identification period does not exceed 200 percent of the aggregate fair market value of all the relinquished properties. With certain exceptions, if, as of the end of the identification period, the taxpayer has identified more properties as replacement properties than is permitted, the taxpayer is treated as if no replacement property had been identified.

The proposed regulations also provide rules for determining whether the identified replacement property is received before the end of the exchange period. In the case of a deferred exchange, the identified replacement property is received before the end of the exchange period if the replacement property is received before the end of the exchange period and the replacement property received is substantially the same property as was identified. If the taxpayer identifies more than 1 property as replacement property, the receipt rules are applied separately to each identified replacement property.

The proposed regulations provide special rules for the identification and receipt of replacement property where the replacement property is not in existence or is being produced or constructed at the time the identification is made.

Receipt of Money or Other Property

Section 1031(a) requires that the relinquished property be transferred solely for property of a like kind. If an exchange would be within the provisions of section 1031(a) but for the fact that the property received in exchange consists not only of property of a like kind but also of money or other property, section 1031(b) provides that the gain, if any, to the taxpayer is recognized in an amount not in excess of the sum of such money and the fair market value of such other property. If an exchange would be within the provisions of section 1031(a) but for the fact that the property received in exchange consists not only of property of a like kind but also of money or other property, section 1031(c) provides that no loss from the exchange is recognized.

Thus, a transfer of relinquished property in a deferred exchange is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or other property. However, such a transfer, if otherwise qualified, will be within the provisions of either section 1031(b) or (c). In addition, in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or other property before the taxpayer actually receives the like-kind replacement property. If the taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives like-kind replacement property, the transaction constitutes a sale and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property.

The application of the foregoing rules are of particular importance to deferred exchanges. For example, after a taxpayer has transferred the relinquished property, the taxpayer typically is unwilling to rely on the transferee's unsecured promise to transfer the like-kind replacement property. Thus, taxpayers often structure deferred exchanges where the transferee's obligation to transfer the like-kind replacement property to the taxpayer is guaranteed or secured. In addition, taxpayers will often receive interest or a growth factor to compensate them for the time value of money for the period between the date on which they transfer the relinquished property and the date on which they receive the replacement property. Finally, in many deferred exchanges the person who desires to purchase the taxpayer's relinquished property may be unwilling or unable to acquire the replacement property. In such cases, the deferred exchange may be facilitated by the use of an intermediary.

As a general rule, a transaction such as one described in the preceding paragraph will constitute a sale and not a deferred exchange if the taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives the like-kind replacement property. However, the rules of actual and constructive receipt may be unclear or of uncertain application in such transactions. In order to provide clear rules for such typical transactions, the proposed regulations provide 4 safe harbors the use of which will result in a determination that the taxpayer is not in actual or constructive receipt of money or other property for purposes of these regulations. However, even if a transaction is within the safe harbors,

to the extent the taxpayer has the ability or unrestricted right to receive money or other property before the taxpayer actually receives like-kind replacement property, the transfer of the relinquished property will not qualify for nonrecognition of gain or loss under section 1031(a). These safe harbors thus apply only until the taxpayer has such an ability or unrestricted right.

Under the first safe harbor, the obligation of the taxpayer's transferee to transfer the replacement property to the taxpayer is permitted to be secured or guaranteed by (a) a mortgage, deed of trust, or other security interest in property (other than cash or a cash equivalent), (b) a standby letter of credit which satisfies all of the requirements of §15A.453-1(b)-(3)(iii) and which does not allow the taxpayer to draw on such standby letter of credit except upon a default of such transferee's obligation to transfer like-kind replacement property, or (c) a guarantee of a third party.

Under the second safe harbor, the obligation of the taxpayer's transferee to transfer the replacement property is permitted to be secured by cash or a cash equivalent if such cash or cash equivalent is held in a qualified escrow account or a qualified trust. In order for an escrow account or trust to be "qualified," the escrow holder or trustee, as the case may be, must not be the taxpayer or a related party, and the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held in escrow or trust must be limited to certain specified circumstances.

Under the third safe harbor, deferred exchanges are permitted to be facilitated by the use of a qualified intermediary if the taxpayer's rights to receive money or other property are limited to certain specified circumstances. A qualified intermediary is a person who is not the taxpayer or a related party and who, for a fee, acts to facilitate a deferred exchange by entering into an agreement with the taxpayer for the exchange of properties pursuant to which such person acquires the relinquished property from the taxpayer (either on its own behalf or as the agent of any party to the transaction), acquires the replacement property (either on its own behalf or as the agent of any party to the transaction), and transfers the replacement property to the taxpayer. The qualified intermediary is considered to have acquired property even if such acquisition is subject to a binding commitment to retransfer the property. Consistent with Rev. Rul. 90-34, page 154, this Bulletin, the transfer of property in a deferred exchange that is facilitated by the use of a qualified intermediary may occur via a "direct deed" of legal title by the current owner of the property to its ultimate owner.

Under the fourth safe harbor, the taxpayer is permitted to receive interest or a growth factor with respect to the deferred exchange provided the taxpayer's rights to receive such interest or growth factor are limited to certain specified circumstances. Such interest or growth factor will be treated as interest regardless of whether it is paid in cash or in property (including property of a like kind). The proposed regulations do not address the proper manner for reporting interest income earned on money held in a qualified escrow account or a qualified trust. Comments are requested concerning whether the Service should exercise its regulatory authority under section 468B(g) with respect to escrow accounts and trusts used in deferred exchanges.

It is expected that most deferred exchange transactions where taxpayers desire nonrecognition of gain or loss under section 1031 can be structured to come within the safe harbors. Transactions not structured to come within the safe harbors will be carefully scrutinized.

The rules provided in these regulations relating to actual or constructive receipt are merely intended to be rules for determining whether there is actual or constructive receipt in the case of a deferred exchange under section 1031. No inference is intended regarding the application of these rules for purposes of determining whether actual or constructive receipt exists for any other purpose.

Gain or Loss and Basis Computations for Deferred Exchanges

As a general rule, the amount of gain or loss recognized and the basis of property received in a deferred exchange is determined by applying the existing rules of section 1031 and the regulations thereunder. For example, in a deferred exchange, consideration given in the form of an assumption of liabilities (or the receipt of property subject to a liability) may be offset against consideration received in the form of an assumption of liabilities (or a transfer subject to a liability).

INTERESTS IN A PARTNERSHIP

Section 77 of the Act amended section 1031 to provide that section 1031(a) does not apply to any exchange of interests in a partnership. Under the proposed regulations, an exchange of partnership interests will not qualify for nonrecognition of gain or loss under section 1031(a) regardless of whether the interests exchanged are general or limited partnership interests or are interests in the same partnership or in different partnerships. This provision is not intended to affect the applicability of the rule stated in Rev. Rul. 84-52, 1984-1 C.B. 157, concerning conversions of partnership interests.

No inference is intended with respect to whether an exchange of an interest in an organization which has elected under section 761(a) to be excluded from the application of subchapter K is eligible for nonrecognition of gain or loss under section 1031(a). Comments are requested concerning the proper resolution of this issue.

Simplification

In drafting these proposed regulations, consideration has been given to ways in which the regulations can be simplified. Structuring a deferred exchange to qualify under section 1031 can be difficult due to uncertainties which are inherent in these transactions. The statute requires that the replacement property be "identified" but does not give specific guidance as to what constitutes a proper identification. Similarly, although the determination of whether there has been a deferred exchange (and not a sale) often turns on whether the taxpayer is in actual or constructive receipt of money or other property, application of the rules of actual or constructive receipt to deferred exchanges under section 1031 may be unclear in some cases.

The proposed regulations are intended to ease taxpayer concerns relating to these uncertainties. One way in which the proposed regulations accomplish this is by setting forth safe harbors under which taxpayers may structure their transactions and be assured that, for purposes of section 1031, actual or constructive receipt will be deemed not to exist. In addition, the proposed regulations ease taxpayer concerns by providing rules that taxpayers can rely upon in identifying replacement property. The proposed regulations further simplify the identification process, for example, by permitting taxpayers to identify replacement property in a written agreement or another written document. Taxpayers are not required to file a separate identification form with the Internal Revenue Service.

Comments are requested on other ways in which the regulations could be further clarified or simplified.

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Request to appear at Public Hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably a signed original and 8 copies) to the Internal Revenue Service. All comments will be made available for public inspection and copying. A public hearing will be held at 10:00 a.m. on September 5 and 6, 1990, in the IRS Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. See the notice of hearing published *** [Announcement 90-76, 1990-26 I.R.B. 29].

List of Subjects

26 CFR 1.1001-1 through 1.1102-3

Basis, Gain and loss, Income taxes, Nontaxable exchanges.

Proposed Amendments to the Regulations

The proposed amendments to 26 CFR, Part 1, are as follows:

PART 1—INCOME TAX REGULATIONS

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1031 (a)-1 is amended by revising paragraph (a), adding headings for paragraphs (b), (c), and (d), and adding paragraph (e) to read as follows:

§1.1031(a)-1 Property held for productive use in a trade or business or for investment.

(a) *In general*—(1) *Exchanges of property solely for property of a like kind.* Section 1031(a)(1) provides an exception from the general rule requiring the recognition of gain or loss upon the sale or exchange of property. Under section 1031(a)(1), no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a like kind to be held either for productive use in a trade or business or for investment. Under section 1031(a)(1), property held for productive use in a trade or business may be exchanged for property held for investment. Similarly, under section 1031(a)(1), property held for investment may be exchanged for property held for productive use in a trade or business. However, section 1031(a)(2) provides that section 1031(a)(1) does not apply to any exchange of—

(i) Stock in trade or other property held primarily for sale;

(ii) Stocks, bonds, or notes;

(iii) Other securities or evidences of indebtedness or interest;

(iv) Interests in a partnership;

(v) Certificates of trust or beneficial interests; or

(vi) Choses in action.

Section 1031(a)(1) does not apply to any exchange of interests in a partnership regardless of whether the interests exchanged are general or limited partnership interests or are interests in the same partnership or in different partnerships.

(2) *Exchanges of property not solely for property of a like kind.* A transfer is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or property which does not meet the requirements of section 1031(a), but the transfer, if otherwise qualified, will be within the provisions of either section 1031(b) or (c). Similarly, a transfer is not within the provisions of section 1031(a) if, as part of the consideration, the other party to the exchange assumes a liability of the taxpayer (or acquires property from the taxpayer that is subject to a liability), but the transfer, if otherwise qualified, will be within the provisions of either section 1031(b) or (c). A transfer of property meeting the requirements of section 1031(a) may be within the provisions of section 1031(a) even though the taxpayer transfers in addition property not meeting the requirements of section 1031(a) or money. However, the nonrecognition treatment provided by section 1031(a) does not apply to the property transferred which does not meet the requirements of section 1031(a).

(b) *Definition of "like kind."* * * *

(c) *Examples of exchanges of property of a "like kind."* * * *

(d) *Examples of exchanges not solely in kind.* * * *

(e) *Effective date.* This section applies to transfers of property made by taxpayers after July 18, 1984, in taxable years ending after that date. This section, however, does not apply in the case of any exchange pursuant to a binding contract in effect on March 1, 1984, and at all times thereafter before the exchange. This section also does not apply to any exchange of an interest as general partner pursuant to a plan of reorganization of ownership interest under a contract which took effect on March 29, 1984, and which was executed on or before March 31, 1984, but only if all the exchanges contemplated by the reorganization plan were completed by December 31, 1984.

Par. 3. A new §1.1031(a)-3 is added in the appropriate place to read as follows:

§1.1031(a)-3 Treatment of deferred exchanges.

(a) *Overview.* This section provides rules for the application of section 1031 and the regulations thereunder in the case of a "deferred exchange." For purposes of section 1031 and this section, a deferred exchange is defined as an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the "relinquished property") and subsequently receives property to be held either for productive use in a trade or business or for investment (the "replacement property"). In the case of a deferred exchange, if the requirements set forth in paragraphs (b), (c), and (d) of this section (relating to identification and receipt of replacement property) are not satisfied, the replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property. In order to constitute a deferred exchange, the transaction must be an exchange (i.e., a transfer of property for property, as distinguished from a transfer of property for money). For example, a sale of property followed by a purchase of property of a like kind does not qualify for nonrecognition of gain or loss under section 1031 regardless of whether the identification and receipt requirements of section 1031(a)(3) and paragraphs (b), (c), and (d) of this section are satisfied. The transfer of relinquished property in a deferred exchange is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or property which does not meet the requirements of section 1031(a), but the transfer, if otherwise qualified, will be within the provisions of either section 1031(b) or (c). See §1.1031(a)-1(a)(2). In addition, in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or property which does not meet the requirements of section 1031(a) before the taxpayer actually receives like-kind replacement property. If the taxpayer actually or constructively receives money or property which does not meet the requirements of section 1031(a) in the full amount of the consideration for the relinquished property, the transaction will constitute a sale, and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property. For purposes of this section, property which does not meet the requirements of section 1031(a) (whether by being described in section 1031(a)(2) or otherwise) is referred to as "other property." For rules regarding actual and constructive receipt, and safe harbors thereto, see paragraphs (f) and (g), respectively. For rules regarding the determination of gain or loss recognized and the basis of property received in a deferred exchange, see paragraph (j) of this section.

(b) *Identification and receipt requirements*—(1) *In general.* In the case of a deferred exchange, any replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property if—

(i) The replacement property is not "identified" before the end of the "identification period," or

(ii) The identified replacement property is not received before the end of the "exchange period."

(2) *Identification period and exchange period.* (i) The identification period begins on the date the taxpayer transfers the relinquished property and ends 45 days thereafter.

(ii) The exchange period begins on the date the taxpayer transfers the relinquished property and ends on the earlier of 180 days thereafter or the due date (including extensions) for the taxpayer's return of the tax imposed by chapter 1 of Subtitle A of the Code for the taxable year in which the transfer of the relinquished property occurs.

(iii) If, as part of the same deferred exchange, the taxpayer transfers more than 1 relinquished property and the relinquished properties are transferred on different dates, the identification period and the exchange period are determined by reference to the earliest date on which any of such properties are transferred. For purposes of determining the date on which the identification period or the exchange period ends, section 7503 (relating to time for performance of acts where the last day for performance falls on a Saturday, Sunday, or legal holiday) does not apply.

(3) *Example.* The application of this paragraph (b) may be illustrated by the following example.

Example. (*i*) M is a corporation that files its federal income tax return on a calendar year basis. M and C enter into an agreement for an exchange of property that requires M to transfer property X to C. Under the agreement, M is required to identify like-kind replacement property which C is required to purchase and to transfer to M. M transfers property X to C on November 17, 1990.

(*ii*) The identification period ends on January 1, 1991, the day which is 45 days after the date of transfer of property X, even though it is New Year's Day. The exchange period ends on March 15, 1991, the due date for M's federal income tax return for the taxable year in which M transferred property X. However, if M is allowed the automatic six-month extension for filing its tax return, the exchange period ends on May 16, 1991, the day which is 180 days after the date of transfer of property X.

(c) *Identification of replacement property before the end of the identification period*—(1) *In general.* For purposes of paragraph (b)(1)(i) of this section (relating to the identification requirement), replacement property is identified before the end of the identification period only if the requirements of this paragraph (c) are satisfied with respect to the replacement property. However, in the case of a deferred exchange, any replacement property that is received by the taxpayer before the end of the identification period will in all events be treated as identified before the end of the identification period.

(2) *Manner of identifying replacement property.* Replacement property is identified only if it is designated as replacement property in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or otherwise sent before the end of the identification period to a person involved in the exchange other than the taxpayer or a related party (as defined in paragraph (k) of this section). An identification of replacement property made in a written agreement for the exchange of properties signed by all parties thereto before the end of the identification period will be treated as satisfying the requirements of the preceding sentence, regardless of whether the agreement is "sent" to a person involved in the exchange.

(3) *Description of replacement property.* Replacement property is identified only if it is unambiguously described in the written document or agreement. Real property generally is

unambiguously described if it is described by a legal description or street address. Personal property generally is unambiguously described if it is described by a specific description of the particular type of property. For example, a truck generally is unambiguously described if it is described by a specific make, model, and year.

(4) *Alternative and multiple properties.* (i) The taxpayer may identify more than 1 property as replacement property. Regardless of the number of relinquished properties transferred by the taxpayer as part of the same deferred exchange, the maximum number of replacement properties that the taxpayer may identify is—

(A) Three properties without regard to the fair market values of the properties (the "3-property rule"), or

(B) Any number of properties as long as their aggregate fair market value as of the end of the identification period does not exceed 200 percent of the aggregate fair market value of all the relinquished properties as of the date the relinquished properties were transferred by the taxpayer (the "200-percent rule").

(ii) If, as of the end of the identification period, the taxpayer has identified more properties as replacement properties than permitted by paragraph (c)(4)(i) of this section, the taxpayer is treated as if no replacement property had been identified. The preceding sentence will not apply, however, and an identification satisfying the requirements of paragraph (c)(4)(i) will be considered made, with respect to—

(A) Any replacement property received by the taxpayer before the end of the identification period, and

(B) Any replacement property identified before the end of the identification period and received before the end of the exchange period, but only if the taxpayer receives identified replacement property constituting at least 95 percent of the aggregate fair market value of all identified replacement properties before the end of the exchange period.

(iii) For purposes of applying the 3-property rule and the 200-percent rule, all identifications of property as replacement property, other than identifications of property as replacement property which have been revoked in the manner provided in paragraph (c)(6) of this section, are taken into account. For example, if, in a deferred exchange, B transfers property X with a fair market value of $100,000 to C and B receives like-kind property Y with a fair market value of $50,000 before the end of the identification period, under paragraph (c)(1) of this section, property Y is treated as identified by reason of being received before the end of the identification period. Thus, under paragraph (c)(4)(i), B may identify either two additional replacement properties of any fair market value or any number of additional replacement properties as long as the aggregate fair market value of the additional replacement properties does not exceed $150,000.

(5) *Incidental property disregarded.* (i) Solely for purposes of applying this paragraph (c), property that is incidental to a larger item of property is not treated as property that is separate from the larger item of property. Property is incidental to a larger item of property if—

(A) In standard commercial transactions, the property is typically transferred together with the larger item of property, and

(B) The aggregate fair market value of all such property does not exceed 15 percent of the aggregate fair market value of the larger item of property.

(ii) *Examples.* The application of this paragraph (c)(5) may be illustrated by the following examples.

Example 1. For purposes of paragraph (c) of this section, a spare tire and tool kit will not be treated as separate property from a truck with a fair market value of $10,000, if the aggregate fair market value of the spare tire and tool kit does not exceed $1,500. In such case, for purposes of the 3-property rule, the truck, spare tire, and tool kit are treated as 1 property. Moreover, for purposes of paragraph (c)(3) of this section (relating to the description of replacement property), the truck, spare tire, and tool kit are all considered to be unambiguously described if the make, model, and year of the truck are specified, even if no reference is made to the spare tire and tool kit.

Example 2. For purposes of paragraph (c) of this section, furniture, laundry machines, and other miscellaneous items of personal property will not be treated as separate property from an apartment building with a fair market value of $1,000,000 if the aggregate fair market value of the furniture, laundry machines, and other personal property does not exceed $150,000. In such case, for purposes of the 3-property rule, the apartment building, furniture, laundry machines, and other personal property are treated as 1 property. Moreover, for purposes of paragraph (c)(3) of this section (relating to the description of replacement property), the apartment building, furniture, laundry machines, and other personal property are all considered to be unambiguously described if the legal description or street address of the apartment building is specified, even if no reference is made to the furniture, laundry machines, and other personal property.

(6) *Revocation of identification.* An identification of property as replacement property may be revoked at any time before the end of the identification period. An identification of property as replacement property is treated as revoked only if such revocation is made in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or otherwise sent before the end of the identification period to the person to whom the identification of the replacement property was sent. An identification of property as replacement property that is made in a written agreement for the exchange of properties is treated as revoked only if such revocation is made in a written amendment to such agreement or in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or otherwise sent before the end of the identification period to all of the parties to the agreement.

(7) *Examples.* The application of this paragraph (c) may be illustrated by the following examples. Unless otherwise provided in an example, the following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B transfers real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of $100,000. On or before July 1, 1991 (the end of the identification period), B is required to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value of real property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received by B. No replacement property is identified in the

agreement. The replacement property is described by legal description and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold the replacement property received for investment.

Example 1. (*i*) On July 2, 1991, B identifies real property H as replacement property by designating real property H as replacement property in a written document signed by B and personally delivered to C.

(*ii*) Because the identification was made after the end of the identification period, pursuant to paragraph (b)(1)(i) (relating to the identification requirement), real property H is treated as property which is not of a like kind to real property X.

Example 2. (*i*) On June 3, 1991, B identifies the replacement property as "unimproved land located in Hood County with a fair market value not to exceed $100,000." The designation is made in a written document signed by B and personally delivered to C. On July 8, 1991, B and C agree that real property H is the property described in the June 3, 1991 document.

(*ii*) Because real property H was not unambiguously described before the end of the identification period, no replacement property was identified before the end of the identification period.

Example 3. (*i*) On June 28, 1991, B identifies real properties J, K, and L as replacement properties by designating such properties as replacement properties in a written document signed by B and personally delivered to C. The written document provides that by August 1, 1991, B will orally inform C which of the identified properties C is to transfer to B. As of July 1, 1991, the fair market values of real properties J, K, and L are $75,000, $100,000, and $125,000, respectively.

(*ii*) Because B did not identify more than 3 properties as replacement properties, the requirements of the 3-property rule are satisfied, and real properties J, K, and L are all identified before the end of the identification period.

Example 4. (*i*) On May 17, 1991, B identifies real properties M, N, P, and Q as replacement properties by designating such properties as replacement properties in a written document signed by B and personally delivered to C. The written document provides that by July 2, 1991, B will orally inform C which of the identified properties C is to transfer to B. As of July 1, 1991, the fair market values of real properties M, N, P, and Q are $30,000, $40,000, $50,000, and $60,000, respectively.

(*ii*) Although B identified more than 3 properties as replacement properties, the aggregate fair market value of the identified properties as of the end of the identification period ($180,000) did not exceed 200 percent of the aggregate fair market value of real property X (200% x $100,000 = $200,000). Therefore, the requirements of the 200-percent rule are satisfied, and real properties M, N, P, and Q are all identified before the end of the identification period.

Example 5. (*i*) On May 20, 1991, B identifies real properties R and S as replacement properties by designating such properties as replacement properties in a written document signed by B and personally delivered to C. On June 4, 1991, B identifies real properties T and U as replacement properties in the same manner. On June 5, 1991, B telephones C and orally revokes the identification of real properties R and S. As of July 1, 1991, the fair market values of real properties R, S, T, and U are $50,000, $70,000, $90,000, and $100,000, respectively.

(*ii*) Pursuant to paragraph (c)(6) of this section (relating to revocation of identification), the oral revocation of the identification of real properties R and S is invalid. Thus, the identification of real properties R and S is taken into account for purposes of determining whether the requirements of paragraph (c)(4) of this section (relating to the identification of alternative and multiple properties) are satisfied. Because B identified more than 3 properties and the aggregate fair market value of the identified properties as of the end of the identification period ($310,000) exceeds 200 percent of the fair market value of real property X (200% x $100,000 = $200,000), the requirements of paragraph (c)(4) are not satisfied, and B is treated as if B did not identify any replacement property.

(d) *Receipt of identified replacement property*—(1) *In general.* For purposes of paragraph (b)(1)(ii) of this section (relating to the receipt requirement), the identified replacement property is received before the end of the exchange period only if the requirements of this paragraph (d) are satisfied with respect to the replacement property. In the case of a deferred exchange, the identified replacement property is received before the end of the exchange period if—

(i) The taxpayer receives the replacement property before the end of the exchange period, and

(ii) The replacement property received is substantially the same property as identified.

If the taxpayer has identified more than 1 property as replacement property, section 1031(a)(3)(B) and this paragraph (d) are applied separately to each replacement property.

(2) *Examples.* The application of this paragraph may be illustrated by the following examples. The following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B transfers real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of $100,000. On or before July 1, 1991 (the end of the identification period), B is required to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value of real property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received by B. The replacement property is identified as provided in paragraph (c) of this section (relating to identification of replacement property) and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold any replacement property received for investment.

Example 1. (*i*) In the exchange agreement, B identifies real properties J, K, and L as replacement properties. The agreement provides that by July 26, 1991, B will orally inform C which of the properties C is to transfer to B.

(*ii*) As of July 1, 1991, the fair market values of real properties J, K, and L are $75,000, $100,000, and $125,000, respectively. On July 26, 1991, B instructs C to acquire real property K. On October 31, 1991, C purchases real property K for $100,000 and transfers the property to B.

(*iii*) Because real property K was identified before the end of the identification period and was received before the end of the exchange period, the identification and receipt requirements of section 1031(a)(3) and this section are satisfied with respect to real property K.

Example 2. (*i*) In the exchange agreement, B identifies real property P as replacement property. Real property P consists of 2 acres of unimproved land and has a fair market value of $250,000. As of October 3, 1991, real property P remains unimproved and has a fair market value of $250,000. On that date, at B's direction, C purchases 1 1/2 acres of real property P for $187,500 and transfers it to B, and B pays $87,500 to C.

(*ii*) The fair market value of the portion of real property P that B received ($187,500) is 75 percent of the fair market value of real property P as of the date of receipt. B is considered to have received substantially the same property as identified.

(e) *Special rules for identification and receipt of replacement property to be produced*—(1) *In general.* A transfer of relinquished property in a deferred exchange will not fail to qualify for nonrecognition of gain or loss under section 1031 merely because the replacement property is not in existence or is being produced at the time the property is identified as replacement property. For purposes of this paragraph, the term "produced" or "production" has the

same meaning as provided in section 263A(g)(1) and the regulations thereunder.

(2) *Identification.* (i) In the case of replacement property that is to be produced, the replacement property must be identified as provided in paragraph (c) of this section (relating to identification of replacement property). For example, if the identified replacement property consists of improved real property where the improvements are to be constructed, the description of the replacement property satisfies the requirements of paragraph (c)(3) (relating to description of replacement property) if a legal description is provided for the underlying land and as much detail as is practicable at the time the identification is made is provided for construction of the improvements.

(ii) For purposes of paragraphs (c)(4)(i)(B) and (5) of this section (relating to the 200-percent rule and incidental property), the fair market value of replacement property that is to be produced is its estimated fair market value as of the date it is expected to be received by the taxpayer.

(3) *Receipt.* (i) For purposes of paragraph (d)(1)(ii) of this section (relating to receipt of the identified replacement property), in determining whether the replacement property received by the taxpayer is substantially the same property as identified where the identified replacement property is property to be produced, variations due to usual or typical production changes are not taken into account. However, if substantial changes are made in the property to be produced, the replacement property received will not be considered to be substantially the same property as identified.

(ii) If the identified replacement property is personal property to be produced, the replacement property received will not be considered to be substantially the same property as identified unless production of the replacement property received is completed on or before the date the property is received by the taxpayer.

(iii) If the identified replacement property is real property to be produced and the production of the property is not completed on or before the date the taxpayer receives the property, the property received will be considered to be substantially the same property as identified only if—

(A) The replacement property received constitutes real property, and

(B) The replacement property received, had production been completed on or before the date the taxpayer received the property, would have been considered to be substantially the same property as identified.

(4) *Additional rules.* The transfer of relinquished property is not within the provisions of section 1031(a) if the relinquished property is transferred in exchange for services (including production services). Thus, any additional production occurring with respect to the replacement property after the property is received by the taxpayer will not be treated as the receipt of property of a like kind.

(f) *Receipt of money or other property*—(1) *In general.* A transfer of relinquished property in a deferred exchange is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or other property. However, such a transfer, if otherwise qualified, will be within the provisions of either section 1031(b) or (c). See §1.1031(a)-1(a)(2). In addition, in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or other property before the taxpayer actually receives like-kind replacement property. If the taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives like-kind replacement property, the transaction will constitute a sale and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property.

(2) *Actual and constructive receipt.* Except as provided in paragraph (g) of this section (relating to safe harbors), for purposes of section 1031 and this section, the determination of whether (or the extent to which) the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made under the general rules concerning actual and constructive receipt and without regard to the taxpayer's method of accounting. The taxpayer is in actual receipt of money or property at the time the taxpayer actually receives such money or property or receives the economic benefit of such money or property. The taxpayer is in constructive receipt of money or property at the time such money or property is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it at any time or so that the taxpayer can draw upon it if notice of intention to withdraw is given. Although the taxpayer is not in constructive receipt of money or property if the taxpayer's control of its receipt is subject to substantial limitations or restrictions, the taxpayer is in constructive receipt of such money or property at the time such limitations or restrictions lapse, expire, or are waived. In addition, actual or constructive receipt of money or property by an agent of the taxpayer (determined without regard to paragraph (k) of this section) is actual or constructive receipt by the taxpayer.

(3) *Example.* The application of this paragraph (f) may be illustrated by the following example.

Example. (*i*) B, a calendar year taxpayer, and C agree to enter into a deferred exchange under the following terms and conditions. On May 17, 1991, B is to transfer real property X to C. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of $100,000. On or before July 1, 1991 (the end of the identification period), B is required to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. At any time after May 17, 1991, and before C has purchased the replacement property, B has the right, upon notice, to demand that C pay $100,000 in lieu of acquiring and transferring the replacement property. Pursuant to the terms of the agreement, B identifies replacement property, and C purchases the replacement property and transfers it to B.

(*ii*) Under the terms of the agreement, B has the unrestricted right to demand the payment of $100,000 as of May 17, 1991. B is therefore in constructive receipt of $100,000 on that date. Because B is in constructive receipt of money in the full amount of the consideration for the relinquished property before B actually receives the like-kind replacement property, the transaction constitutes a sale, and the transfer of real property X does not qualify for nonrecognition of gain or loss under section 1031. B is treated as if B received the $100,000 in consideration for the sale of real property X and then purchased the like-kind replacement property.

(*iii*) If B's right to demand payment of the $100,000 was subject to a substantial limitation

or restriction (e.g., any of the circumstances described in paragraph (g)(6) of this section), then, for purposes of this section, B would not be in actual or constructive receipt of the money unless (or until) the limitation or restriction lapsed, expired, or was waived.

(g) *Safe harbors*—(1) *In general.* Paragraphs (g)(2) through (5) set forth 4 safe harbors the use of which will result in a determination that the taxpayer is not in actual or constructive receipt of money or other property for purposes of section 1031 and this section. However, even if a transaction is within the safe harbors, to the extent the taxpayer has the ability or unrestricted right to receive money or other property before the taxpayer actually receives like-kind replacement property, the transfer of the relinquished property will not qualify for nonrecognition of gain or loss under section 1031(a). These safe harbors thus apply only until the taxpayer has such an ability or unrestricted right. For purposes of this paragraph (g), the person to whom the taxpayer transfers the relinquished property is referred to as the "taxpayer's transferee."

(2) *Security or guarantee arrangements.* In the case of a deferred exchange, the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property will be made without regard to the fact that the obligation of the taxpayer's transferee to transfer the replacement property to the taxpayer is or may be secured or guaranteed by one or more of the following—

(i) A mortgage, deed of trust, or other security interest in property (other than cash or a cash equivalent),

(ii) A standby letter of credit which satisfies all of the requirements of §15A.453-1(b)(3)(iii) and which does not allow the taxpayer to draw on the standby letter of credit except upon a default of the transferee's obligation to transfer like-kind replacement property to the taxpayer, or

(iii) A guarantee of a third party.

(3) *Qualified escrow accounts and qualified trusts.* (i) In the case of a deferred exchange, the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property will be made without regard to the fact that the obligation of the taxpayer's transferee to transfer the replacement property to the taxpayer is or may be secured by cash or a cash equivalent if the cash or cash equivalent is held in a qualified escrow account or in a qualified trust.

(ii) A qualified escrow account is an escrow account where—

(A) The escrow holder is not the taxpayer or a related party (as defined in paragraph (k) of this section), and

(B) The taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held in the escrow account are limited to the circumstances described in paragraph (g)(6) of this section.

(iii) A qualified trust is a trust where—

(A) The trustee is not the taxpayer or a related party (as defined in paragraph (k) of this section), and

(B) The taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held by the trustee are limited to the circumstances described in paragraph (g)(6) of this section.

(4) *Qualified intermediaries.* (i) In the case of a deferred exchange, the determination of whether the transaction will be treated as an exchange and of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property will be made without regard to the fact that the taxpayer's transferee is or may be the taxpayer's agent. This paragraph (g)(4) applies only if—

(A) The taxpayer's transferee is a qualified intermediary, and

(B) The taxpayer's rights to receive money or other property from the qualified intermediary are limited to the circumstances described in paragraph (g)(6) of this section.

(ii) A qualified intermediary is a person who—

(A) Is not the taxpayer or a related party (as defined in paragraph (k) of this section), and

(B) For a fee, acts to facilitate the deferred exchange by entering into an agreement with the taxpayer for the exchange of properties pursuant to which such person acquires the relinquished property from the taxpayer (either on its own behalf or as the agent of any party to the transaction), acquires the replacement property (either on its own behalf or as the agent of any party to the transaction), and transfers the replacement property to the taxpayer.

(5) *Interest and growth factors.* In the case of a deferred exchange, the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives the like-kind replacement property will be made without regard to the fact that the taxpayer is or may be entitled to receive any interest or growth factor with respect to the deferred exchange. The preceding sentence applies only if the taxpayer's rights to receive such interest or growth factor are limited to the circumstances described in paragraph (g)(6) of this section. For additional rules concerning interest or growth factors, see paragraph (h) of this section.

(6) *Additional restrictions on certain safe harbors.* For purposes of paragraphs (g)(3) through (5) of this section, a taxpayer's rights are limited to the circumstances described in this paragraph (g)(6) if the taxpayer does not have the right to receive money or other property until—

(i) If the taxpayer has not identified replacement property before the end of the identification period, after the end of the identification period,

(ii) After the taxpayer has received all of the identified replacement property to which the taxpayer is entitled,

(iii) If the taxpayer identifies replacement property, after the later of the end of the identification period and the occurrence of a material and substantial contingency that—

(A) Relates to the deferred exchange,

(B) Is provided for in writing, and

(C) Is beyond the control of the taxpayer or a related party (as defined in paragraph (k) of this section), or

(iv) Otherwise, after the end of the exchange period.

(7) *Examples.* The application of this paragraph (g) may be illustrated by the following examples. Unless otherwise provided in an example, the following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B trans-

fers real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of $100,000. On or before July 1, 1991 (the end of the identification period), B is required to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value of real property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received by B. The replacement property is identified as provided in paragraph (c) of this section (relating to identification of replacement property) and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold any replacement property received for investment.

Example 1. (i) On May 17, 1991, B transfers real property X to C, and C deposits $100,000 in escrow as security for C's obligation to perform under the agreement. The escrow agreement provides as follows: The funds in escrow are to be used to purchase the replacement property. If B fails to identify replacement property on or before July 1, 1991, B may demand the funds in escrow at any time after July 1, 1991. If B identifies and receives replacement property, then B may demand the balance of the remaining funds in escrow at any time after B has received the replacement property. Otherwise, B is entitled to all funds in escrow after November 13, 1991. The escrow holder is not a related party as defined in paragraph (k) of this section. Pursuant to the terms of the agreement, B identifies replacement property, and C purchases the replacement property using the funds in escrow and transfers the replacement property to B.

(*ii*) Because C's obligation to transfer the replacement property to B was secured by cash held in a qualified escrow account, and B did not have the ability or unrestricted right to the money or other property before B actually received the like-kind replacement property, for purposes of section 1031 and this section, B is determined not to be in actual or constructive receipt of the $100,000 held in escrow before B received the like-kind replacement property.

Example 2. (i) On May 17, 1991, B transfers real property X to C, and C deposits $100,000 in escrow as security for C's obligation to perform under the agreement. Also on May 17, B identifies real property J as replacement property. The escrow agreement provides as follows: The funds in escrow are to be used to purchase the replacement property. B may demand the funds in escrow at any time after the later of July 1, 1991, and the occurrence of any of the following events: (A) real property J is destroyed, stolen, seized, requisitioned, or condemned, or (B) a determination is made that the regulatory approval necessary for the transfer of real property J cannot be obtained in time for real property J to be transferred to B before the end of the exchange period. In addition, B may demand the funds in escrow at any time after August 14, 1991, if real property J has not been rezoned from residential to commercial use by that date. Otherwise, B is entitled to all funds in escrow after the earlier of November 13, 1991, and the time at which B has received all of the identified replacement property to which B is entitled. The escrow holder is not a related person as described in paragraph (k) of this section. Real property J is not rezoned from residential to commercial use on or before August 14, 1991.

(*ii*) From May 17, 1991, until August 15, 1991, C's obligation to transfer the replacement property to B is secured by cash held in a qualified escrow account, and B does not have the ability or unrestricted right to receive money or other property before B actually receives the like-kind replacement property. Therefore, for purposes of section 1031 and this section, B is determined not to be in actual or constructive receipt of the $100,000 in escrow from May 17, 1991, until August 15, 1991. However, on August 15, 1991, B had the unrestricted right, upon notice, to draw upon the $100,000 held in escrow. Because B constructively received the full amount of the consideration ($100,000) before B actually received the like-kind replacement property, the transaction is treated as a sale and not as a deferred exchange. The result does not change merely because B chooses not to demand the funds in escrow and continues to attempt to have real property J rezoned and to receive the property on or before November 13, 1991.

(*iii*) If real property J had been rezoned on or before August 14, 1991, and C had purchased real property J and transferred it to B on or before November 13, 1991, the transaction would have qualified for nonrecognition of gain or loss under section 1031(a).

Example 3. (i) Assume that on May 1, 1991, B enters into an agreement to sell real property X to D for $100,000 on May 17, 1991. On May 16, 1991, B retains C to facilitate a deferred exchange with respect to real property X by entering into a deferred exchange agreement. Under the terms of the deferred exchange agreement, on May 17, 1991, B will transfer real property X to C subject to D's right to purchase real property X for $100,000 on that date. On or before July 1, 1991, B is required to identify replacement property that is of a like kind to real property X. On or before November 13, 1991, C is required to purchase the property identified by B and to transfer that property to B. B's rights to receive money or other property from C are limited to the circumstances described in paragraph (g)(6) of this section. B pays C a fee of $y to facilitate the transaction. C is not a related party as defined in paragraph (k) of this section.

(*ii*) On May 17, 1991, C acquires real property X from B and simultaneously transfers real property X to D in exchange for $100,000. For reasons unrelated to the federal income tax, legal title to real property X is transferred direct from B to D. On June 1, 1991, B identifies real property J as replacement property. On August 9, 1991, C purchases real property J for $100,000 and transfers it to B.

(*iii*) Even though C acquired real property X subject to D's right to purchase the property on prearranged terms and conditions, for purposes of paragraph (g)(4)(ii)(B) of this section (relating to the definition of a qualified intermediary), C acquired real property X. Similarly, C also acquired real property J. Because, in addition, the other requirements of paragraph (g)(4)(ii) are satisfied, C is a qualified intermediary.

(*iv*) Because B's rights to receive money or other property from C were limited to the circumstances described in paragraph (g)(6), under paragraph (g)(4)(i) of this section (relating to qualified intermediaries), B was not in constructive receipt of money or other property before B received real property J. Accordingly, the transfer of real property X by B qualifies for nonrecognition of gain or loss under section 1031(a).

Example 4. (i) Assume that on May 1, 1991, B enters into an agreement to sell real property X to D for $100,000 on May 17, 1991. On May 16, 1991, B retains C to facilitate a deferred exchange with respect to real property X by entering into a deferred exchange agreement. Pursuant to the deferred exchange agreement, on May 17, 1991, B transfers real property X to D and directs D to pay $100,000 to C. On June 28, 1991, B identifies replacement property that is of a like kind to real property X. On November 12, 1991, C purchases the property identified by B for $100,000 and transfers that property to B. B's rights to receive money or other property from C are limited to the circumstances described in paragraph (g)(6) of this section. B pays C a fee of $y to facilitate the transaction. C is not a related party as defined in paragraph (k) of this section and is not D's agent.

(*ii*) Because C did not acquire real property X from B, the requirements of paragraph (g)(4)(ii)(B) of this section (relating to the definition of a qualified intermediary) have not been satisfied, and C is not a qualified intermediary. In addition, because B did not enter into an agreement for the exchange of property but instead entered into separate agreements to sell real property X to D and to purchase other real property, the transaction is not a deferred exchange. Therefore, the transfer of real property X does not qualify for nonrecognition of gain or loss under section 1031.

(h) *Interest and growth factors*—(1) *In general.* For purposes of this section, the taxpayer is treated as being entitled to receive interest or a growth factor with respect to a deferred exchange if the amount of money or property the taxpayer is entitled to receive depends upon the length of time elapsed between transfer of the relinquished property and receipt of the replacement property.

(2) *Treatment as interest.* If, as part of a deferred exchange, the taxpayer receives interest or a growth factor, such interest or growth factor

will be treated as interest, regardless of whether it is paid to the taxpayer in cash or in property (including property of a like kind). The taxpayer must include such interest or growth factor in income according to the taxpayer's method of accounting.

(i) [Reserved]

(j) *Determination of gain or loss recognized and the basis of property received in a deferred exchange*—(1) *In general.* Except as otherwise provided, the amount of gain or loss recognized and the basis of property received in a deferred exchange is determined by applying the rules of section 1031 and the regulations thereunder. See §§1.1031(b)–1, 1.1031(c)–1, 1.1031(d)–1, 1.1031(d)–1T, and 1.1031(d)–2.

(2) *Coordination with section 453.* [Reserved]

(3) *Examples.* The application of this paragraph (j) is illustrated by the following examples. Unless otherwise provided in an example, the following facts are assumed: B, a calendar year taxpayer, and C agree to enter into a deferred exchange. Pursuant to their agreement, B transfers real property X to C on May 17, 1991. Real property X, which has been held by B for investment, is unencumbered and has a fair market value on May 17, 1991, of $100,000. B's adjusted basis in real property X is $40,000. On or before July 1, 1991 (the end of the identification period), B is required to identify replacement property that is of a like kind to real property X. On or before November 13, 1991 (the end of the exchange period), C is required to purchase the property identified by B and to transfer that property to B. To the extent the fair market value of the replacement property transferred to B is greater or less than the fair market value of real property X, either B or C, as applicable, will make up the difference by paying cash to the other party after the date the replacement property is received. The replacement property is identified as provided in paragraph (c) of this section and is of a like kind to real property X (determined without regard to section 1031(a)(3) and this section). B intends to hold any replacement property received for investment.

Example 1. (i) On May 17, 1991, B transfers real property X to C and identifies real property Y as replacement property. On June 3, 1991, C transfers $10,000 to B. On September 4, 1991, C purchases real property Y for $90,000 and transfers real property Y to B.

(*ii*) The $10,000 received by B is "money or other property" for purposes of section 1031 and the regulations thereunder. Under section 1031(b), B recognizes gain in the amount of $10,000. Under section 1031(d), B's basis in real property Y is $40,000 (i.e., B's basis in real property X ($40,000), decreased in the amount of money received ($10,000), and increased in the amount of gain recognized ($10,000) in the deferred exchange).

Example 2. (i) On May 17, 1991, B transfers real property X to C and identifies real property Y as replacement property, and C transfers $10,000 to B. On September 4, 1991, C purchases real property Y for $100,000 and transfers real property Y to B. On the same day, B transfers $10,000 to C. (ii) The $10,000 received by B is "money or other property" for purposes of section 1031 and the regulations thereunder. Under section 1031(b), B recognizes gain in the amount of $10,000. Under section 1031(d), B's basis in real property Y is $50,000 (i.e., B's basis in real property X ($40,000), decreased in the amount of money received ($10,000), increased in the amount of gain recognized ($10,000), and increased in the amount of the additional consideration paid by B ($10,000) in the deferred exchange).

Example 3. (i) Under the exchange agreement, B has the right at all times to demand $100,000 in cash in lieu of replacement property. On May 17, 1991, B transfers real property X to C and identifies real property Y as replacement property.

(*ii*) Because B has the right on May 17, 1991, to demand $100,000 in cash in lieu of replacement property, B is in constructive receipt of the $100,000 on that date. Thus, the transaction is a sale and not an exchange, and the $60,000 gain realized by B in the transaction (i.e., $100,000 amount realized less $40,000 adjusted basis) is recognized. If C subsequently purchases real property Y for $100,000 and transfers it to B, B will have a basis in real property Y of $100,000.

Example 4. (i) Under the exchange agreement, B has the right at all times to demand up to $30,000 in cash and the balance in replacement property instead of receiving replacement property in the amount of $100,000. On May 17, 1991, B transfers real property X to C and identifies real property Y as replacement property.

(*ii*) The transaction qualifies as a deferred exchange under section 1031 and this section. However, because B has the right on May 17, 1991, to demand up to $30,000 in cash, B is in constructive receipt of $30,000 on that date. Under section 1031(b), B recognizes gain in the amount of $30,000. If, before November 13, 1991, C purchases real property Y for $100,000 and transfers it to B, under section 1031 (d), B will have a basis in real property Y of $70,000 (i.e., B's basis in real property X ($40,000), decreased in the amount of money that B received ($30,000), increased in the amount of gain recognized ($30,000), and increased in the amount of additional consideration paid by B ($30,000) in the deferred exchange).

Example 5. (*i*) Assume real property X is encumbered by a mortgage of $30,000. On May 17, 1991, B transfers real property X to C and identifies real property Z as replacement property, and C assumes the $30,000 mortgage on real property X. Real property Z is encumbered by a $20,000 mortgage. On July 5, 1991, C purchases real property Z for $90,000 by paying $70,000 and assuming the mortgage and transfers real property Z to B with B assuming the mortgage.

(*ii*) The consideration received by B in the form of the liability assumed by C ($30,000) is offset by the consideration given by B in the form of the liability assumed by B ($20,000). The excess of the liability assumed by C over the liability assumed by B, $10,000, is treated as "money or other property." See §1.1031(b)–1(c). Thus, under section 1031(b), B recognizes gain under section 1031(b) in the amount of $10,000. Under section 1031(d), B's basis in real property Z is $40,000 (i.e., B's basis in real property X ($40,000), decreased in the amount of money that B is treated as receiving in the form of the liability assumed by C ($30,000), increased in the amount of money that B is treated as paying in the form of the liability assumed by B ($20,000), and increased in the amount of the gain recognized ($10,000) in the deferred exchange).

(k) *Definition of related party*—(1) For purposes of this section, a person is a related party if—

(i) Such person and the taxpayer bear a relationship described in either section 267(b) or section 707(b) (determined by substituting "10 percent" for "50 percent" each place it appears),

(ii) Such person acts as the taxpayer's agent (including, for example, by performing services as the taxpayer's employee, attorney, or broker), or

(iii) Such person and a person described in paragraph (k)(1)(ii) of this section bear a relationship described in either section 267(b) or section 707(b) (determined by substituting "10 percent" for "50 percent" each place it appears).

(2) In determining whether a person acts as the taxpayer's agent, solely for purposes of this paragraph (k), the following are not taken into account—

(i) The performance of services for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under section 1031, and

(ii) The performance by a financial institution of routine financial services for the taxpayer.

(l) *Definition of fair market value.* For purposes of this section, the fair market value of property means the fair market value of the property without regard to liabilities.

(m) *No inference with respect to actual or constructive receipt rules outside of section 1031.* The rules

provided in this section relating to actual or constructive receipt are merely intended to be rules for determining whether there is actual or constructive receipt in the case of a deferred exchange. No inference is intended regarding the application of these rules for purposes of determining whether actual or constructive receipt exists for any other purpose.

(n) *Effective date.* This section generally applies to transfers of property by a taxpayer made after July 2, 1990. This section does not apply to any transfer made pursuant to a written binding contract in effect on May 16, 1990, and at all times thereafter before the transfer. A contract will not fail to qualify under the written binding contract exception in the preceding sentence solely because the contract provides in the alternative for an exchange or a sale or solely because the property to be received in the exchange was not identified on or before May 16, 1990.

Fred T. Goldberg, Jr.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on May 15, 1990, 8:45 a.m., and published in the issue of the Federal Register for May 16, 1990, 55 F.R. 20278)

Notice of Proposed Rulemaking

Information Reporting on Real Estate Transactions

IA-130-87

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains a notice of proposed rulemaking relating to the information reporting requirements for real estate transactions contained in section 6045(e). Changes to the applicable law were made by the Tax Reform Act of 1986, the Technical and Miscellaneous Revenue Act of 1988, and Subtitle G (the Improved Penalty Administration and Compliance Tax Act) of the Revenue Reconciliation Act of 1989. The proposed regulations would affect certain persons who participate in real estate transactions and provide them with the guidance needed to comply with the law. The proposed regulations would supersede §1.6045-3T on becoming effective.

DATES: The proposed regulations are proposed to be effective for real estate transactions with dates of closing occurring on or after January 1, 1991. Written comments must be received by June 18, 1990.

Outlines for persons wishing to speak at the public hearing scheduled for September 24, 1990, must be delivered by September 10, 1990. *See* the Notice of Public Hearing published elsewhere in *** [Announcement 90-67, 1990-20 I.R.B. 19].

ADDRESS: Send comments and requests to speak at the public hearing to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044, Attn: CC:CORP:T:R Room 4429 (IA-130-87). In the alternative, comments and requests may be hand-delivered to: Internal Revenue Service, Attn: CC:CORP:T:R (IA-130-87), Room 4429, Washington, D.C. 20224.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1980 (44 U.S.C. 3504(h)). Comments concerning the accuracy of the burden estimate and suggestions for reducing the burden should be directed to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer T:FP, Washington, D.C. 20224.

The collections of information in this regulation are in proposed §1.6045-4(a), (d)(3), (e)(5), (h), (l), and (m). This information is required by the Internal Revenue Service pursuant to section 6045(e). This information will be used to verify that a taxpayer properly reported a sale or exchange of real estate. The likely respondents are businesses or other for-profit institutions, governmental units, and individuals.

Estimated total annual reporting and recordkeeping burden: 84,000 hours.

The estimated annual burden per respondent/recordkeeper varies from .10 to 1.00 hours depending on individual circumstances, with an estimated average of .28 hours.

Estimated number of respondents and recordkeepers: 300,000.

Estimated annual frequency of responses: One time.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents/recordkeepers may require greater or less time, depending on their particular circumstances.

Background

This document proposes §1.6045-4 that would supersede §1.6045-3T of the Income Tax Regulations (26 CFR Part 1) to provide rules relating to the information reporting requirements for real estate transactions under section 6045(e) of the Internal Revenue Code of 1986. The proposed amendments reflect the addition of section 6045(e) to the Code by section 1521 of the Tax Reform Act of 1986 (100 Stat. 2746) [Pub. L. 99-514, 1986-3 C.B. (Vol. 1) 1, 663]. Section 6045(e) subsequently was amended by section 1015(e) of the Technical and Miscellaneous Revenue Act of 1988 ("TAMRA"), (P.L. 100-647, 102 Stat. 3342), enacted on November 10, 1988. Subtitle G (the Improved Penalty Administration and Compliance Tax Act) of The Revenue Reconciliation Act of 1989, (P.L. 101-239, 103 Stat. 2106) [page 210, this Bulletin], makes changes to magnetic media and penalty provisions of the Code that relate to the reporting requirements.

On April 3, 1987, temporary regulations (§1.6045-3T) relating to information reporting on real estate transactions were published in the Federal Register (52 FR 10742) [T.D. 8135, 1987-1 C.B. 312]. In addition, a cross-reference notice of proposed rulemaking (proposed §1.6045-3) was published in that issue of the Federal Register (52 FR 10774) [LR-95-86,

1987-1 C.B. 804]. Those temporary regulations provided that the reporting requirements would apply to sales and exchanges of certain residential real estate ("one-to-four-family real estate"). However, the preamble to the temporary regulations also contained a statement that the Internal Revenue Service anticipated the issuance of additional regulations applying the information reporting requirements to other transactions.

More than 50 written comments were received in response to the cross-reference notice of proposed rulemaking. A Notice of Public Hearing was published on June 19, 1987, in the Federal Register (52 FR 23308). The public hearing was held on July 22, 1987. Five commentators spoke at the public hearing.

In Announcement 88-16, 1988-5 I.R.B. 28, the Service provided notice that additional regulations would be issued to require reporting with respect to additional transactions, and that the additional reporting requirements would apply on a prospective basis only.

This document proposes to amend §1.6045-3T to limit the application of those regulations to real estate transactions with dates of closing occurring prior to January 1, 1991.

This document proposes to apply the real estate information reporting requirements to a broad variety of real estate transactions, well beyond the scope of §1.6045-3T. The new rules are separately contained in new proposed §1.6045-4. In addition, §1.6045-4 proposes rules that specify which real estate transactions and which transferors of otherwise reportable real estate are excepted from the new reporting requirements. The proposed rules relating to the determination of who is responsible for reporting, and the rules relating to time, manner, and place of reporting are substantially the same as in §1.6045-3T.

Explanation of Provisions

Under the proposed regulations, the term "real estate transaction" would include only a sale or exchange of reportable real estate. The proposed regulations would define the term "reportable real estate" to include any present or future ownership interest in: (a) improved and unimproved land, including air space; (b) inherently permanent structures, including any residential, commercial or industrial building; (c) any condominium unit and its appurtenant fixtures and common elements (including land); or (d) stock in a cooperative housing corporation (as defined in section 216).

The term "ownership interest" includes fee simple interests, life estates, reversions, remainders, and perpetual easements. The term "ownership interest" also includes any previously created rights to possession or use for all or a portion of any particular year (i.e., a leasehold, easement, or "timeshare"), provided such rights have a remaining term of at least 30 years, including any period for which such rights may be renewed at the option of the holder of such rights, determined immediately prior to the current transfer. However, the term "ownership interest" does not include an option to acquire reportable real estate.

The proposed regulations would except certain transfers from the reporting requirements: (a) transactions that are not sales or exchanges; (b) foreclosures (modifying the exception contained in §1.6045-3T, which only applies to transactions subject to reporting under §6050J); and (c) de minimis transfers in which the total consideration (in money, services, and property) received or to be received is determinable with certainty and amounts to less than $250 in value as measured on the date of closing. The Service considers the exception for de minimis transfers to be appropriate given the extensive range of interests in real estate, including easements, sold for nominal consideration that would otherwise be subject to the proposed reporting requirements. The Service welcomes comments on this proposed exception, in particular the amount proposed.

Unlike §1.6045-3T, the proposed rules contained in proposed §1.6045-4 do not include an exception for involuntary conversions involving a sale or exchange. Thus, for example, a sale of reportable real estate, under threat or imminence of seizure, requisition, or condemnation, that occurs on or after the effective date of §1.6045-4 is subject to the reporting requirements of those proposed regulations.

In addition, the proposed regulations would except certain property from the reporting requirements (provided the sale or exchange of such property is not related to the sale or exchange of reportable real estate): (a) an interest in surface or subsurface natural resources, or crops; (b) a burial plot or vault; and (c) an unaffixed mobile home (modifying the exception provided in §1.6045-3T, which contained an exception based on the presence of wheels and axles).

Under the proposed regulations, transactions involving foreign transferors would be subject to information reporting under section 6045(e). However, the Internal Revenue Service is studying the relationship between the provisions of the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) and section 6045(e), to determine whether any exception under section 6045(e) is appropriate solely because of the foreign status of the transferor(s). Taxpayers are urged to comment on the interaction between these provisions.

No return of information would be required with respect to a transferor that is a corporation under section 7701(a)(3) or section 7704(a) or that is treated, under the proposed regulations, as a corporation, a governmental unit, or an exempt volume transferor (as defined in the proposed regulations).

The Internal Revenue Service is considering the implementation of new compliance programs to more effectively use returns of information on corporate (and other business) recipients of income. Thus, the appropriateness of the exception for corporate transferors may be reviewed at a later date. However, the Service welcomes comments on whether certain corporations should continue to be excepted from the reporting requirements, even if the general exception for corporate transferors is removed.

Establishing exempt volume transferor status would require a certification under penalties of perjury. The certification would have to be in accordance with the requirements of the proposed regulations. To promote simplification in the reporting rules, the proposed regulations would allow a reporting person to report even if the requisite certification of exempt volume transferor status is provided.

The proposed regulations would provide rules for determining the person (referred to in section 6045(e), as amended, and these regulations as the "reporting person"), who is required to report with respect to a real estate transaction. Following is a summary of these rules, which would be substantially the same as in §1.6045-3T.

Although there may be a number of persons involved in a real estate transaction, only the reporting person is required to report. Thus, for example, if the reporting person with respect to a transaction fails to report, no other person involved in the transaction will have a duty to report.

Unless a different person is identified as the reporting person in a designation agreement that meets the requirements of the regulations, the reporting person with respect to a transaction is generally the person responsible for closing the transaction.

If a Uniform Settlement Statement, prescribed under the Real Estate Settlement Procedures Act of 1974 (RESPA), 12 U.S.C. 2601, *et seq.*, as amended, and the regulations thereunder, is used with respect to a real estate transaction, the person listed as the settlement agent on that statement is considered the person responsible for closing the transaction. That is the case even if the person listed as the settlement agent on that statement is an agent of another person involved in the transaction.

If a Uniform Settlement Statement is not used, or if no person is listed as settlement agent on the Uniform Settlement Statement, the person responsible for closing the transaction is the person who prepares the closing statement or other written description of the disposition of the gross proceeds used at, or in connection with, the closing.

If no closing statement or other written description of the disposition of the gross proceeds is used, the person responsible for closing the transaction is a transferee's or transferor's attorney who participates in the transaction in the manner specified in the regulations, or, if there is no such attorney, the disbursing title or escrow company that is most significant in terms of gross proceeds disbursed. If the transferee's attorney and the transferor's attorney both participate in the transaction in the manner specified, the person considered responsible for closing the transaction is the transferee's attorney.

If no person is responsible for closing the transaction (and there is no designation agreement that meets the requirements of the regulations), the reporting person with respect to the transaction is the first-listed of the persons that participate in the transaction as (a) the mortgage lender, (b) the transferor's broker, (c) the transferee's broker, or (d) the transferee.

The proposed regulations provide that the participants in a real estate transaction may, by agreement, designate a person as the reporting person with respect to the transaction. Only the person responsible for closing the transaction, an attorney for the transferee or transferor, a title or escrow company, or a mortgage lender may be designated under such an agreement. A designation agreement must be in writing. Persons other than the designated person may be parties to the agreement. The agreement must be available for inspection by any person involved in the real estate transaction, or by the Internal Revenue Service. If these conditions are met and the agreement otherwise satisfies the requirements of the proposed regulations, the designated person (and not the person who would otherwise be the reporting person) is the real estate reporting person with respect to the transaction.

The proposed regulations prescribe the information required to be shown on the return and on the statement furnished to the transferor, the manner in which the return must be filed with the Service and the statement must be furnished to the transferor, and the time for filing such returns and furnishing such statements.

The proposed regulations would provide special rules for transactions involving multiple transferors. The proposed regulations generally would require a reporting person to make a separate information return with respect to each transferor and to request an allocation of the gross proceeds from the transferors. Transferors who are husband and wife and who hold the real estate at the time of closing as a tenancy in common, a joint tenancy, a tenancy by the entirety, or community property are, in the absence of an uncontested allocation received by the reporting person, not considered multiple transferors for purposes of these rules.

The proposed regulations require magnetic-media reporting for real estate transactions, but provide an exception for persons who meet the de minimis standard established in section 6011(e)(2) of the Code, as amended. In addition, the Commissioner may authorize reporting on the prescribed paper Form 1099 if undue hardship is shown.

The proposed regulations also provide rules for the solicitation of taxpayer identification numbers (TINs) from transferors, but do not require backup withholding with respect to real estate transactions reportable under section 6045(e). The solicitation must be made by providing a written statement containing certain information to the transferor. This statement may be provided to the transferor in person or in a mailing that includes other items.

Pursuant to section 6045(e)(3), as added by TAMRA, no separate charge may be made for complying with any of the requirements of this section.

The amendments contained in section 1.6045-4 are proposed to apply to real estate transactions with dates of closing occurring on or after January 1, 1991.

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these proposed regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted, consideration will be given to any written comments that

are submitted (preferably nine copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing is scheduled for September 24, 1990. Notice of the public hearing is published in *** [Announcement 90-67, 1990-20 I.R.B. 19].

List of subjects

26 CFR 1.6001-1 through 1.6109-2

Income taxes, Administration and procedure, Filing requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Proposed amendments to the Regulations

The proposed amendments to 26 CFR Parts 1 and 602 are as follows:

PART 1—INCOME TAX; CALENDAR YEARS BEGINNING AFTER DECEMBER 31, 1986

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Section 1.6045-4 also issued under 26 U.S.C. 6045.

Par. 2. Section 1.6045-3T is amended by revising the heading and revising paragraph (p) as follows:

§1.6045-3T Information reporting on real estate transactions with dates of closing that occur after December 31, 1986, and prior to January 1, 1991 (Temporary).

* * * * *

(p) *Effective date*—This section shall be effective for real estate transactions with dates of closing (as determined under paragraph (h)(2)(ii) of this section) that occur after December 31, 1986, and prior to January 1, 1991. No penalty will be imposed with respect to a transaction with a date of closing that occurs before May 4, 1987.

Par. 3. The following new §1.6045-4 is added in the appropriate place.

§ 1.6045-4 Information reporting on real estate transactions with dates of closing on or after January 1, 1991.

(a) *Requirement of reporting.* Except as otherwise provided in paragraphs (c) and (d) of this section, a real estate reporting person ("reporting person") must make an information return with respect to a real estate transaction and, under paragraph (m) of this section, must furnish a statement to the transferor. A reporting person may also report with respect to transactions otherwise excepted in paragraphs (c) and (d) of this section. However, if the reporting person so elects, the return must be filed and the statement furnished in accordance with the provisions of this section. For the definition of a real estate transaction for purposes of these reporting requirements, see paragraph (b) of this section. For rules for determining the reporting person with respect to a real estate transaction, see paragraph (e) of this section.

(b) *Definition of real estate transaction*—(1) *In general.* A transaction is a "real estate transaction" under this section if the transaction consists in whole or in part of the sale or exchange of "reportable real estate" (as defined in paragraph (b)(2) of this section) for money, indebtedness, property other than money, or services. The term "sale or exchange" shall include any transaction properly treated as a sale or exchange for Federal income tax purposes, whether or not the transaction is currently taxable. Thus, for example, a sale or exchange of a principal residence is a real estate transaction under this section even though the transferor is entitled to defer recognition under section 1034 (relating to rollover of gain on sale of principal residence), or the transferor is entitled to the special one-time exclusion of gain from the sale of a principal residence provided by section 121 to certain persons who have attained age 55.

(2) *Definition of reportable real estate.* Except as otherwise provided in paragraph (c)(2) of this section, the term "reportable real estate" means any present or future ownership interest in—

(i) Land (whether improved or unimproved), including air space;

(ii) Any inherently permanent structure, including any residential, commercial or industrial building;

(iii) Any condominium unit, including appurtenant fixtures and common elements (including land); or

(iv) Any stock in a cooperative housing corporation (as defined in section 216).

For purposes of this section, the term "ownership interest" includes fee simple interests, life estates, reversions, remainders, and perpetual easements. In addition, the term "ownership interest" includes any previously created rights to possession or use for all or a portion of any particular year (*i.e.*, a leasehold, easement, or "timeshare"), with a remaining term of at least 30 years, including any period for which such rights may be renewed at the option of the holder of the rights, as determined on the date of closing (as defined in paragraph (h)(2)(ii) of this section). Thus, for example, a pre-existing leasehold on a building with an original term of 99 years is an ownership interest in real estate for purposes of this section if it has a remaining term of 35 years as of the date of closing, but not if it has a remaining term of only 10 years as of the date of closing. However, the term "ownership interest" does not include an option to acquire otherwise reportable real estate.

(c) *Exception for certain exempt transactions*—(1) *Certain transfers.* No return of information is required with respect to—

(i) A transaction that is not a sale or exchange (such as a gift (including a transaction treated as a gift under section 1041) or bequest, or a financing or refinancing that is not related to the acquisition of reportable real estate), even if the transaction involves reportable real estate, as defined in paragraph (b)(2) of this section;

(ii) A transfer in full or partial satisfaction of any indebtedness secured by the property so transferred including a foreclosure, a transfer in lieu of foreclosure or an abandonment; or

(iii) A transaction (a "de minimis transfer") in which it can be determined with certainty that the total consideration (in money, services and property), received or to be received, amounts to less than $250 in value as measured on the date of closing (as defined in paragraph (h)(2)(ii) of this section), even if the transaction involves reportable real estate. Thus, for example, if a contract for sale of reportable real estate recites total consideration of "$1.00 plus other

valuable consideration," the transfer is not a de minimis transfer unless the reporting person can determine that the "other valuable consideration" received or to be received is less than $249 in value as measured on the date of closing.

(2) *Certain property.* Notwithstanding the provisions of paragraph (b)(2) of this section, no return of information is required with respect to a sale or exchange of an interest in any of the following property—provided the sale or exchange of such property is not related to the sale or exchange of reportable real estate—

(i) An interest in surface or subsurface natural resources (*i.e.*, timber, water, ores and other natural deposits) or crops, whether or not such natural resources or crops are severed from the land;

(ii) A burial plot or vault; or

(iii) A manufactured structure used as a dwelling that is manufactured and assembled at a location different from that where it is used, but only if such structure is not affixed, at the date of closing (as defined in paragraph (h)(2)(ii) of this section), to a foundation. Thus, a transfer of an unaffixed mobile home that is unrelated to the sale or exchange of reportable real estate is excepted from the reporting requirements of this section.

(d) *Exception for certain exempt transferors*—(1) *General rule.* No return of information is required with respect to a transferor that is a corporation under section 7701(a)(3) or section 7704(a) or is considered under paragraph (d)(2) of this section to be—

(i) A corporation;

(ii) A governmental unit; or

(iii) An exempt volume transferor.

In the case of a real estate transaction with respect to which there is one or more exempt transferor(s) and one or more non-exempt transferor(s), the reporting person is required to report with respect to any non-exempt transferor. The special rule for allocation of gross proceeds, as provided in paragraph (i)(5) of this section, applies to such a transaction.

(2) *Treatment as exempt transferor.* Absent actual knowledge to the contrary, a reporting person may treat a transferor as—

(i) A corporation if—

(A) The name of the transferor contains an unambiguous expression of corporate status, such as Incorporated, Inc., Corporation, Corp., or P.C. (but not Company or Co.);

(B) The name of the transferor contains the term "insurance company," "reinsurance company," or "assurance company"; or

(C) The transfer or loan documents clearly indicate the corporate status of the transferor;

(ii) A governmental unit if the transferor is—

(A) The United States or a state, the District of Columbia, a possession of the United States, a political subdivision of any of the foregoing, or any wholly owned agency or instrumentality of any one or more of the foregoing; or

(B) A foreign government, a political subdivision thereof, an international organization, as defined in section 7701 (a)(18), or any wholly-owned agency or instrumentality of the foregoing; or

(iii) An exempt volume transferor if, and only if, the reporting person receives a certification of exempt status under paragraph (d)(3) of this section.

(3) *Certification of exempt status*—(i) *In general.* A certification of exempt status must contain—

(A) The name, address, and taxpayer identification number of the transferor (the address must be that of the permanent residence (in the case of an individual), that of the principal office (in the case of a corporation or partnership), or that of the permanent residence or principal office of any fiduciary (in the case of a trust or estate));

(B) Sufficient information to identify any otherwise reportable real estate not reported by virtue of the exempt status of the transferor; and

(C) A declaration that the transferor has sold or exchanged during either of the prior two calendar years, or previously sold or exchanged during the current calendar year, or, as of the date of closing (as defined in paragraph (h)(2)(ii) of this section), reasonably expects to sell or exchange during the current calendar year at least 25 separate items of reportable real estate (as defined in paragraph (b)(2) of this section) to at least 25 separate transferees, and that each such item, at the date of closing of the sale of such item was or will be held primarily for sale or resale to customers in the ordinary course of a trade or business. For example, the declaration may be worded as follows:

_____ [INSERT NAME OF TRANSFEROR]

[check one or more]:

(1) __ has sold or exchanged during either of the prior two calendar years,

(2) __ previously sold or exchanged during the current calendar year,

(3) __ on the date of closing expects to sell or exchange during the current calendar year,

at least 25 separate items of reportable real estate to at least 25 separate transferees and each such item, at the date of closing of such item was or will be held primarily for sale or resale to customers in the ordinary course of a trade or business.

(ii) *Additional requirements.* A certification of exempt status must be—

(A) Signed under penalties of perjury by the transferor or any person who is authorized to sign a declaration under penalties of perjury in behalf of the transferor as described in section 6061 and the regulations thereunder;

(B) Received by the reporting person no later than the time of closing; and

(C) Retained by the reporting person for four years following the close of the calendar year in which the date of closing (as determined under paragraph (h)(2)(ii) of this section) occurs.

(iii) *Reporting person may accept or disregard certification.* A reporting person may solicit or merely accept a certification of exempt status. Moreover, notwithstanding a transferor's furnishing of such certification, a reporting person may disregard the certification and, instead, report with respect to the transaction. See paragraph (a) of this section for the requirement that such elective reporting must be in compliance with the provisions of this section.

(e) *Person required to report*—(1) *In general.* Although there may be other persons involved in a real estate

transaction, only the reporting person is required to report with respect to any real estate transaction. Except as provided in a designation agreement under paragraph (e)(5) of this section, the reporting person with respect to a real estate transaction is—

(i) The person responsible for closing the transaction, as defined in paragraph (e)(3) of this section; or

(ii) If there is no person responsible for closing the transaction, the person determined to be the reporting person under paragraph (e) (4) of this section.

A person may be the reporting person with respect to a transaction whether or not such person performs or is licensed to perform real estate brokerage services for a commission or fee.

(2) *Employees, agents, and partners.* For purposes of this paragraph (e), if an employee, agent, or partner (other than an employee, agent, or partner of the transferor or the transferee) acting within the scope of such person's employment, agency, or partnership participates in a real estate transaction—

(i) Such participation shall be attributed to such person's employer, principal, or partnership; and

(ii) Only the employer, principal, or partnership (and not such person) may be the reporting person with respect to such transaction as a result of such participation.

However, the participation of a person described in paragraph (e)(3)(i) of this section (*i.e.*, a person listed on the Uniform Settlement Statement as the settlement agent) acting as an agent of another is not attributed to the principal.

(3) *Person responsible for closing the transaction*— (i) *Uniform Settlement Statement used.* If a Uniform Settlement Statement prescribed under the Real Estate Settlement Procedures Act of 1974 (RESPA), 12 U.S.C. 2601 *et seq.* (a "Uniform Settlement Statement"), is used with respect to the real estate transaction and a person is listed as settlement agent on the statement, such person is the person responsible for closing the transaction. For purposes of this section, a Uniform Settlement Statement shall include any amendments or variations thereto, or substitutions therefor that may hereafter be prescribed under RESPA, provided that any such amended, varied, or substituted form requires disclosure of the parties to the transaction, the application of the proceeds of the transaction, and the identity of the settlement agent or other person responsible for preparing the form.

(ii) *Other closing statement used.* If a Uniform Settlement Statement is not used, or if a Uniform Settlement Statement is used, but no person is listed as settlement agent, the person responsible for closing the transaction is the person who prepares a closing statement presented to the transferor and transferee at, or in connection with, the closing of the real estate transaction. For purposes of this section, a closing statement is any closing statement, settlement statement (including a Uniform Settlement Statement), or other written document that identifies the transferor and transferee, reasonably identifies the transferred real estate, and describes the manner in which the proceeds payable to the transferor are to be (or were) disbursed at, or in connection with, the closing.

(iii) *No closing statement used or multiple closing statements used.* If no closing statement is used or multiple closing statements are used, the person responsible for closing the transaction is the first-listed of the persons that participate in the transaction as—

(A) The attorney for the transferee who is present at the occasion of the delivery of either the transferee's note or a significant portion of the cash proceeds to the transferor, or who prepares or reviews the preparation of the document(s) transferring legal or equitable ownership of the real estate;

(B) The attorney for the transferor who is present at the occasion of the delivery of either the transferee's note or a significant portion of the cash proceeds to the transferor, or who prepares or reviews the preparation of the document(s) transferring legal or equitable ownership of the real estate; or

(C) The disbursing title or escrow company that is most significant in terms of gross proceeds disbursed.

If more than one attorney would be the person responsible for closing the transaction under the preceding sentence, the person among such attorneys who is considered responsible for closing the transaction under this paragraph is the person whose involvement in the transaction is most significant.

(4) *Determination of the real estate reporting person in the absence of a person responsible for closing the transaction.* If no person is responsible for closing the transaction (within the meaning of paragraph (e)(3) of this section), the reporting person with respect to the real estate transaction is the person first-listed below of the persons that participate in the transaction as—

(i) The mortgage lender (as defined in paragraph (e)(6)(i) of this section);

(ii) The transferor's broker (as defined in paragraph (e)(6)(ii) of this section);

(iii) The transferee's broker (as defined in paragraph (e)(6)(iii) of this section); or

(iv) The transferee (as defined in paragraph (e)(6)(iv) of this section).

(5) *Designation agreement*—(i) *In general.* If a written designation agreement executed at or prior to the time of closing designates one of the persons described in paragraph (e)(5)(ii) of this section as the reporting person with respect to the transaction and the designated person is a party to the agreement, the designated person is the reporting person with respect to the transaction. It is not necessary that all parties to the transaction (or that more than one party) be parties to the agreement.

(ii) *Persons eligible.* A person may be designated as the reporting person under this paragraph (e)(5) only if the person is—

(A) The person responsible for closing the transaction (as defined in paragraph (e)(3) of this section);

(B) A person described in paragraph (e)(3)(iii)(A), (B) or (C) of this section (whether or not such person is responsible for closing the transaction); or

(C) The mortgage lender (as defined in paragraph (e)(6)(i) of this section).

(iii) *Form of designation agreement.* A designation agreement may be in any form that is consistent with the requirements of this paragraph

(e)(5), and may be included on a closing statement with respect to the transaction. The designation agreement must, however, include the name and address of the transferor and transferee and the address and any additional information necessary to identify the real estate transferred. The agreement must identify, by name and address, the person designated as the reporting person with respect to the transaction, and all other parties (if any) to the agreement. All parties to the agreement must date and sign the agreement and must retain the agreement for four years following the close of the calendar year in which the date of closing (as determined under paragraph (h)(2)(ii) of this section) occurs. Upon request by the Internal Revenue Service, or any person involved in the transaction who did not participate in the designation agreement, the agreement must be made available for inspection.

(6) *Meaning of terms*—(i) *Mortgage lender.* For purposes of this paragraph (e), the term "mortgage lender" means the person who lends new funds in connection with the transaction, but only if the repayment of such funds is secured in whole or in part by the real estate transferred. If new funds are advanced by more than one person, the mortgage lender is the person who advances the largest amount of new funds. If two or more persons advance equal amounts of new funds and no other person advances a greater amount of new funds, the mortgage lender among the persons advancing such equal amounts is the person with the security interest that is most senior in terms of priority. For purposes of this paragraph (e)(6)(i), any amounts advanced by the transferor are not treated as new funds.

(ii) *Transferor's broker.* For purposes of this paragraph (e), the term "transferor's broker" means only the broker that contracts with the transferor and is compensated in connection with the transaction.

(iii) *Transferee's broker.* For purposes of this paragraph (e), the term "transferee's broker" means only the broker that participates to a significant extent in the preparation of the transferee's offer to acquire the real estate or that presents such offer to the transferor. If more than one person is so described, the transferee's broker is the person whose participation in the preparation of the transferee's offer to acquire the real estate is most significant or, in the event there is no such person, the person whose participation in the presentation of the offer is most significant.

(iv) *Transferee.* For purposes of this paragraph (e), the term "transferee" means the person who acquires the greatest interest in the real estate. If there is no such person, the transferee is the person listed first on the document(s) transferring legal or equitable ownership of the real estate.

(f) *Multiple transferors*—(1) *General rule.* In the case of multiple transferors, each of which transfers an interest in the same reportable real estate, the reporting person shall make a separate information return with respect to each transferor. Paragraph (i)(5) of this section provides rules for the determination of gross proceeds to be reported in the case of multiple transferors.

(2) *Rules for spouses.* Transferors who are husband and wife at the time of closing and hold the reportable real estate as tenants in common, joint tenants, tenants by the entirety, or community property are treated as a single transferor for purposes of paragraphs (f)(1), (h)(1)(i), (l)(1) and (i)(5) of this section, unless the reporting person receives, at or prior to the time of closing, an uncontested allocation of gross proceeds between them. In the case of a husband and wife treated as a single transferor, the reporting person may treat either as the transferor for purposes of paragraphs (h)(1)(i) and (l)(1) of this section, relating to reporting and soliciting taxpayer identification numbers.

(g) *Prescribed form.* Except as otherwise provided in paragraph (k) of this section, the information return required by paragraph (a) of this section shall be made on Form 1099.

(h) *Information required*—(1) *In general.* The following information must be set forth on the Form 1099 required by this section:

(i) The name, address, and taxpayer identification number (TIN) of the transferor (see also paragraph (f)(2) of this section);

(ii) A general description of the real estate transferred (in accordance with paragraph (h)(2)(i) of this section);

(iii) The date of closing (as defined in paragraph (h)(2)(ii) of this section);

(iv) To the extent required by the Form 1099 and its instructions, the entire gross proceeds with respect to the transaction (as determined under the rules of paragraph (i) of this section), and, in the case of multiple transferors, the gross proceeds allocated to the transferor (as determined under paragraph (i)(5) of this section);

(v) If the transferor received (or will receive) property (other than cash and consideration treated as cash in computing gross proceeds) or services as part of the consideration for the transaction or if the transferor may receive property (other than cash) or services in satisfaction of an obligation having a stated principal amount, an indication that such property or services were (or will, or may, be) so received;

(vi) The real estate reporting person's name, address, and TIN;

(vii) [Reserved]; and

(viii) Any other information required by the Form 1099 or its instructions.

(2) *Meaning of terms*—(i) *General description of the real estate transferred.* A general description of the real estate transferred includes the complete address of the property. If the address would not sufficiently identify the property, a general description of the real estate also includes a legal description (*e.g.*, section, lot, and block) of the property.

(ii) *Date of closing.* In the case of a real estate transaction with respect to which a Uniform Settlement Statement is used, the date of closing shall be the date (if any) properly described as the "Settlement Date" on such statement. In all other cases, the date of closing shall be the earlier of the date on which title is transferred or the date on which the economic burdens and benefits of ownership of the real estate shift from the transferor to the transferee.

(i) *Gross proceeds*—(1) *In general.* Except as otherwise provided in this paragraph (i), the term "gross proceeds" means the total cash received or to be received by or on behalf of the transferor in connection with the real estate transaction. The stated principal amount of any obligation to pay cash to or for the benefit of the

transferor in the future (including any obligation having a stated principal amount that may be satisfied by the delivery of property (other than cash) or services) and the amount of any liability of the transferor assumed by the transferee as part of the consideration for the transfer or of any liability to which the real estate acquired is subject (whether or not the transferor is personally liable for the debt) shall be treated as cash received or to be received by the transferor in computing gross proceeds. Thus, gross proceeds does not include the value of any property (other than cash and consideration treated as cash) or services transferred in connection with the real estate transaction. See paragraph (h)(1)(v) of this section for the information that must be included on the Form 1099 required by this section in cases in which the transferor receives (or will, or may, receive) property (other than cash and consideration treated as cash) or services as part of the consideration for the transfer.

(2) *Treatment of sales commissions and similar expenses.* In computing gross proceeds, the total cash received or to be received by or on behalf of the transferor shall not be reduced by expenses borne by the transferor (such as sales commissions, expenses of advertising the real estate, expenses of preparing the deed, and the cost of legal services in connection with the transfer).

(3) *Special rule for contingent payments.* Gross proceeds shall not include contingent payments. For purposes of this section, a payment shall not be considered contingent if the only contingencies are remote and incidental or relate to insolvency or default.

(4) *Uniform Settlement Statement used.* If a Uniform Settlement Statement is used with respect to a real estate transaction involving a transfer of reportable real estate solely for cash and consideration treated as cash in computing gross proceeds, the gross proceeds generally will be the same amount as the contract sales price properly shown on that statement.

(5) *Special rules for multiple transferors*—(i) *General rules.* In the case of multiple transferors (within the meaning of paragraph (f) of this section) each of which transfers an interest in the same reportable real estate, the reporting person must request the transferors to provide an allocation of the gross proceeds among the transferors. The request must be made at or before the time of closing. Neither the request nor the response is required to be in writing. The reporting person must make a reasonable effort to contact all transferors of whom the reporting person has actual knowledge. The reporting person may, however, rely on the unchallenged response of any transferor and need not make additional efforts to contact other transferors after at least one complete allocation (whether or not contained in a single response) is received. Except as otherwise provided in this paragraph (i)(5), the reporting person shall report the gross proceeds in accordance with the allocation received. If no gross proceeds are allocated to a transferor because no allocation or an incomplete allocation is received by the reporting person, the reporting person shall report the entire unallocated gross proceeds (if any) on the return of information made with respect to such transferor. If the reporting person receives conflicting allocations from the transferors, the reporting person shall report the entire gross proceeds on each return of information made with respect to the transaction.

(ii) *Rules for spouses.* The reporting person need not request an allocation of gross proceeds if the only transferors are husband and wife at the time of closing. If there are other transferors, the reporting person need only make a reasonable effort to contact either the husband or wife in connection with the request for an allocation. See paragraph (f)(2) of this section for rules that treat a husband and wife as multiple transferors if an uncontested allocation of gross proceeds is received by the reporting person at or prior to the time of closing.

(6) *Multiple asset transactions.* In the case of a real estate transaction reportable under this section that involves the transfer of reportable real estate and other assets, the amount attributable to both the real estate and other assets is treated as the gross proceeds with respect to that real estate transaction. No allocation of gross proceeds is made among the assets.

(j) *Time and place for filing.* A reporting person shall file the information returns required by this section with respect to a real estate transaction after December 31 of the calendar year that includes the date of closing (as determined under paragraph (h)(2)(ii) of this section) and on or before February 28 of the following calendar year. The returns shall be filed with the appropriate Internal Revenue Service Center at the address listed in the Instructions to Form 1099.

(k) *Use of magnetic media and substitute forms*—(1) *Magnetic media*—(i) *General rule.* A reporting person that is required to make a return of information under this section shall, except as otherwise provided in paragraph (k)(1)(ii) or (iii) of this section, submit the information required by this section on magnetic media (within the meaning of 26 CFR 301.6011-2). Returns on magnetic media shall be made in accordance with 26 CFR 301.6011-2 and applicable revenue procedures.

(ii) *Exception for low-volume filers.* For rules allowing a reporting person to make the information returns required by this section on the prescribed paper Form 1099 if the reporting person is required by this section to file fewer than 250 returns during the calendar year, see section 6011(e) and guidance issued by the Internal Revenue Service thereunder.

(iii) *Undue hardship.* The Commissioner may authorize a reporting person to file information returns on the prescribed paper Form 1099 instead of on magnetic media if undue hardship is shown either on Form 8508, Request for Waiver From Filing Information Returns on Magnetic Media, or on a written statement requesting a waiver for undue hardship filed with the Martinsburg Computing Center, Martinsburg, West Virginia in accordance with applicable revenue procedures.

(2) *Substitute forms.* A reporting person that is described in paragraph (k)(1)(ii) of this section or that receives permission to file returns on the prescribed paper Form 1099 under paragraph (k)(1)(iii) of this section may prepare and use a form that contains provisions identical with

those of Form 1099 if the reporting person complies with all applicable revenue procedures relating to substitute Form 1099, including any requirement relating to the use of machine-readable paper forms.

(l) *Requesting taxpayer identification numbers (TINs)— (1) Solicitation*—(i) *General requirements.* A reporting person who is required to make an information return with respect to a real estate transaction under this section must solicit a TIN from the transferor at or before the time of closing. The solicitation may be made in person or in a mailing that includes other items. Any person whose TIN is solicited under this paragraph (l) must furnish such TIN to the reporting person and certify that the TIN is correct. See paragraph (f)(2) of this section for rules that treat a husband and wife as a single transferor (and provide for the TIN solicitation of either) in the absence of an allocation of gross proceeds under paragraph (i)(5) of this section.

(ii) *Content of solicitation.* The solicitation shall be made by providing to the person from whom the TIN is solicited a written statement that the person is required by law to furnish a correct TIN to the reporting person, and that the person may be subject to civil or criminal penalties for failing to furnish a correct TIN. For example, the solicitation may be worded as follows:

> You are required by law to provide [insert name of reporting person] with your correct taxpayer identification number. If you do not provide [insert name of reporting person] with your correct taxpayer identification number, you may be subject to civil or criminal penalties imposed by law.

The solicitation shall contain space for the name, address, and TIN of the person from whom the TIN is solicited and for the person to certify under penalties of perjury that the TIN furnished is that person's correct TIN. The wording of the certification must be substantially similar to the following: "Under penalties of perjury, I certify that the number shown on this statement is my correct taxpayer identification number." The requirements of this paragraph (l)(1)(ii) may be met by providing to the transferor a copy of Form W-9. In the case of a real estate transaction for which a Uniform Settlement Statement is used, the requirements of this paragraph (l)(1)(ii) may be met by providing to the transferor a copy of such statement that is modified to conform to the requirements of this paragraph (l)(2).

(iii) *Retention requirement.* The solicitation shall be retained by the reporting person for four years following the close of the calendar year that includes the date of closing (as determined under paragraph (h)(2)(ii) of this section). Such solicitation must be made available for inspection upon request by the Internal Revenue Service.

(2) *No TIN provided.* A reporting person that does not receive the transferor's TIN will not be subject to any penalty cross-referenced in paragraph (n) of this section by reason of failure to report such TIN if the reporting person has complied with the requirements of paragraph (l)(1) of this section in good faith (determined with proper regard for a course of conduct and the overall results achieved for the year).

(m) *Furnishing statements to transferors*—(1) *Requirement of furnishing statements.* A reporting person who is required to make a return of information under paragraph (a) of this section shall furnish to the transferor whose TIN is required to be shown on the return a written statement of the information required to be shown on such return. The written statement must bear either the legend shown on the recipient copy of Form 1099 or the following:

> This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction will be imposed on you if this item is required to be reported and the IRS determines that it has not been reported.

This requirement may be satisfied by furnishing to the transferor a copy of a completed Form 1099 (or substitute Form 1099 that complies with current revenue procedures). In the case of a real estate transaction for which a Uniform Settlement Statement is used, this requirement also may be satisfied by furnishing to the transferor a copy of a completed statement that is modified to comply with the requirements of this paragraph (m), and by designating on the Uniform Settlement Statement the items of information (such as gross proceeds or allocated gross proceeds) required to be set forth on the Form 1099. For purposes of this paragraph (m), a statement shall be considered furnished to a transferor if it is given to the transferor in person, either at the closing or thereafter, or is mailed to the transferor at the transferor's last known address.

(2) *Time for furnishing statement.* The statement required under this paragraph (m) shall be furnished to the transferor on or after the date of closing and before February 1 of the following calendar year.

(n) *Cross-reference to penalties.* See the following sections regarding penalties for failure to comply with the requirements of section 6045(e) and this section:

(1) Section 6721 for failure to file a correct information return;

(2) Section 6722 for failure to furnish a correct statement to the transferor;

(3) Section 6723 for failure to comply with other information reporting requirements (including the requirement to furnish a TIN);

(4) Section 6724 for definitions and rules relating to waiver and payment; and

(5) Section 7203 for willful failure to supply information (including a taxpayer identification number).

(o) *No separate charge.* A reporting person may not separately charge any person involved in a real estate transaction for complying with any requirements of this section.

(p) *Backup withholding requirements.* [Reserved.]

(q) *Effective date.* This section shall be effective for real estate transactions with dates of closing (as determined under paragraph (h)(2)(ii) of this section) that occur on or after January 1, 1991.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. Section 602.101 (c) is amended by inserting in the appropri-

ate place in the table "1.6045-4 ... 1545-1085".

Fred T. Goldberg, Jr.
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on April 17, 1990, 8:45 a.m., and published in the issue of the Federal Register for April 18, 1990, 55 F.R. 14429)

Notice of Proposed Rulemaking

Like-Kind Exchanges—Additional Rules for Exchanges of Personal Property and for Exchanges of Multiple Properties

IA-12-89

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that amend §§1.1031(a)-1 and 1.1031(b)-1(c) of the Income Tax Regulations and add new §§1.1031(a)-2 and 1.1031(f)-1. Section 1031(a)(1) of the Internal Revenue Code of 1986 (Code), as amended, provides that no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment if that property is exchanged solely for property of a like kind that is to be held either for productive use in a trade or business or for investment. Existing §1.1031(a)-1(b) provides that the nonrecognition rules of section 1031 do not apply to an exchange of one kind or class of property for property of a different kind or class. The proposed regulations provide additional guidance for determining whether personal property has been exchanged for property of a like kind or like class. Section 1.1031(b)-1(c) is amended to clarify the treatment of liabilities incurred by the taxpayer in anticipation of an exchange under section 1031. Proposed rules are also provided for determining gain recognized and the basis of property received under section 1031 with respect to exchanges of multiple properties, including exchanges of entire businesses.

DATES: These proposed regulations are proposed to be effective for exchanges occurring after the date of publication of the final regulations in the Federal Register. Written comments and requests for a public hearing must be received by July 25, 1990.

ADDRESS: Send comments and requests for a public hearing to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, (Attn: CC:CORP:T:R (IA-12-89)), Room 4429, Washington, D.C. 20044.

SUPPLEMENTAL INFORMATION:

Background

This document contains proposed amendments and additions to the Income Tax Regulations under section 1031 of the Internal Revenue Code of 1986, as amended. These proposed amendments and additions provide additional rules for determining the applicability of section 1031 in an exchange of personal property, as well as rules for determining gain recognized and the basis of property received in an exchange of multiple properties under section 1031. In addition, the treatment of liabilities incurred by the taxpayer in anticipation of an exchange under section 1031 is clarified.

Explanation of Provisions

EXCHANGES OF PERSONAL PROPERTY

Section 1031(a)(1) provides that no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment if the property is exchanged solely for property of a "like kind" that is to be held either for productive use in a trade or business or for investment. Section 1.1031(a)-1(b) of the regulations provides that the nonrecognition rules of section 1031 do not apply to an exchange of one kind or class of property for property of a different kind or class. The proposed regulations set forth additional rules for determining whether personal property has been exchanged for property of a "like kind."

Under the proposed regulations, depreciable tangible personal property held for productive use in a business is exchanged for property of a "like kind" under section 1031 if the property is exchanged for property that is either of a like kind or of a like class. An exchange of properties of a like kind may qualify for nonrecognition of gain or loss under section 1031 regardless of whether such properties are also of a like class. In addition, the proposed regulations provide that an exchange of properties of a like class may similarly qualify for nonrecognition of gain or loss under section 1031.

In general, depreciable tangible personal property held by the taxpayer for productive use in its business is of a like class to other depreciable tangible personal property to be held by the taxpayer for productive use in its business if the exchanged properties are either within the same "General Business Asset Class" or within the same "Product Class." For purposes of the proposed regulations, property may not be classified within more than one General Business Asset Class or more than one Product Class. Further, property within any General Business Asset Class may not be classified within a Product Class.

General Business Asset Classes

There are 13 General Business Asset Classes, which consist of depreciable tangible personal property described in asset classes 00.11 through 00.28 and 00.4 of Rev. Proc. 87-56, 1987-2 C.B. 674, as modified. Rev. Proc. 87-56 provides a classification system for property for the purpose of determining depreciation deductions under section 168 of the Code. These General Business Asset Classes describe types of depreciable tangible personal property that are frequently used in many businesses. For example, the first three General Business Asset Classes are office furniture, fixtures, and equipment; information systems; and data handling equipment.

Product Classes

Product Classes consist of depreciable tangible personal property listed in a Product Code. A property's Product Code is its five-digit product class under the product coding system of the U.S. Department of Commerce, Bureau of the Census, 1987 Census of Manufactures and Census of Mineral Industries, 1989 Reference Series: *Numerical List of Manufactured and Mineral Products (Issued*

February 1989). The *Numerical List of Manufactured and Mineral Products* (Stock No. 003-024-06925-3) may be purchased from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402, (202-783-3238, not a toll-free number). If obtaining the publication directly from the U.S. Government Printing Office is not practicable or feasible, taxpayers should contact the Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, (Attn: CC:CORP:T:R (IA-12-89)), Room 4429, Washington, D.C. 20044, for assistance.

The *Numerical List of Manufactured and Mineral Products* lists principal products and services of the manufacturing and mining industries in the United States and thus lists substantially all of the various types of depreciable tangible personal property. Each of these products is assigned a seven-digit code. The first five digits (in some cases, the fifth digit may be a letter) of the seven-digit code represent a product class. This product coding system is an extension by the Bureau of the Census of the four-digit industrial classification of the manufacturing and mining industries as defined in the *Standard Industrial Classification System. For further information, see Executive Office of the President, Office of Management and Budget, Standard Industrial Classification Manual: 1987.*

The *Numerical List of Manufactured and Mineral Products* contains some five-digit product classes that do not describe depreciable tangible personal property (e.g., food and mineral products). For purposes of the proposed regulations, Product Classes are limited to Product Codes that describe depreciable tangible personal property.

Other Personal Property

Under the proposed regulations, an exchange of intangible personal property, nondepreciable personal property, or personal property held for investment may qualify for nonrecognition of gain or loss under section 1031 only if the exchanged properties are of a like kind. These types of property have not been divided into like classes because of the variety of such personal property and the lack of generally available classification systems. For example, the nature or character of intangible personal property is generally dependent not only on the type of right involved (*e.g.*, a patent or a copyright) but also on the type of underlying property to which the intangible personal property relates. Thus, although the differences between copyrights on different novels may best be described as differences of grade or quality, the differences between a copyright on a novel and a copyright on a song may best be described as differences of nature or character. For these reasons, no like classes are provided in the proposed regulations for intangible personal property, nondepreciable personal property, and personal property held for investment. Special rules are provided for exchanges of goodwill or going concern value.

TREATMENT OF LIABILITIES

Section 1.1031(b)-1(c) of the existing regulations provides that consideration received in the form of an assumption of liabilities (or a transfer subject to a liability) is to be treated as "other property or money" for purposes of section 1031(b). Where each party to the exchange either assumes a liability of the other party or acquires property subject to a liability, then, in determining the amount of "other property or money" for purposes of section 1031(b), consideration given in the form of an assumption of liabilities (or a receipt of property subject to a liability) is offset against consideration received in the form of an assumption of liabilities (or a transfer subject to a liability). Additional rules are provided in §1.1031(d)-2, examples (1) and (2).

The proposed regulations amend §1.1031(b)-1(c) to clarify that, in determining the amount of "other property or money" for purposes of section 1031(b), consideration received by the taxpayer in the form of an assumption of liabilities (or a transfer subject to a liability) may not be offset by consideration given by the taxpayer in the form of an assumption of liabilities (or a receipt of property subject to a liability) with respect to liabilities incurred by the taxpayer in anticipation of an exchange under section 1031. This amendment is intended to clarify current law.

EXCHANGES OF MULTIPLE PROPERTIES

As a general rule, the application of section 1031 requires a property-by-property comparison for computing the gain recognized and basis of property received in a like-kind exchange. The proposed regulations provide an exception to this general rule in the case of an exchange of multiple properties. An exchange is an exchange of multiple properties if the properties transferred by the taxpayer in the exchange can be separated into more than one exchange group (as described below). For example, an exchange of apartment buildings may be an exchange of multiple properties if, in addition to real property, personal property is transferred and received by the taxpayer in the exchange. Exchanges of entire businesses are also exchanges of multiple properties.

An exchange group consists of all properties transferred and received in the exchange which are of a "like kind." The separation of the properties transferred and the properties received by the taxpayer in the exchange into exchange groups requires a matching up of properties of a like kind or like class to the extent possible. For example, all properties within the same General Business Asset Class would be in the same exchange group. Thus, in an exchange of automobiles and computers for other automobiles and computers, two exchange groups would be created—one consisting of the automobiles transferred and received as part of the exchange and the other consisting of the computers transferred and received as part of the exchange.

To the extent the aggregate fair market value of the properties transferred and the properties received in each exchange group are not equal, a portion of the "other property or money" received as part of the exchange is allocated among the exchange groups in order to equalize the aggregate fair market value of the properties transferred and the aggregate fair market value of the properties received in each exchange group. For this purpose, "other property or money" received as part of the exchange includes property described in section 1031(a)(2) (*i.e.*, stock in trade or other property held primarily for sale, stocks, bonds, notes, other secu-

rities or evidences of indebtedness or interest, interests in a partnership, certificates of trust or beneficial interests, or choses in action), property received that is not of a like kind with any property transferred, and money. If in an exchange group the aggregate fair market value of the like kind property received exceeds the aggregate fair market value of the like kind property transferred, the excess is allocated to other exchange groups where it is treated as "other property or money" received in the exchange.

For example, assume a taxpayer exchanges an automobile with a fair market value of $1100 and a computer with a fair market value of $800 for an automobile with a fair market value of $800, a computer with a fair market value of $1000, and $100 cash, as follows:

	Property Transferred	*Property Received*
Automobiles	$1100	$ 800
Computers	800	1000
Cash	—	100

The properties exchanged are first separated into two exchange groups. The first exchange group consists of the automobile with a fair market value of $1100 being exchanged for the automobile with a fair market value of $800 and the second exchange group consists of the computer with a fair market value of $800 being exchanged for the computer with a fair market value of $1000. In order to equalize the aggregate fair market value of the properties transferred and the aggregate fair market value of the properties received in each exchange group, the $100 cash and one-fifth of the computer received by the taxpayer (*i.e.*, $200 worth of the computer) are allocated to the first exchange group and treated as "other property or money" received in exchange for the automobile transferred by the taxpayer.

Once exchange groups are created, the rules of section 1031 and the regulations thereunder are applied separately to each exchange group to determine the amount of gain recognized and the basis of the property received in the exchange. For example, if the aggregate adjusted basis of the properties transferred in an exchange group exceeds the aggregate fair market value of the properties received in the exchange group the realized loss is not recognized under sections 1031(a) and (c). In the case of the previous example, the amount realized on the exchange of the automobile is $1100. If the adjusted basis of the automobile transferred by the taxpayer was $400, then, under section 1031(b), the gain realized on the exchange ($700) is recognized in an amount not in excess of the sum of the money received ($100) and the fair market value of the other property received ($200, which is one-fifth of the fair market value of the computer received in the exchange), resulting in total gain recognized with respect to the exchange group of $300.

Liabilities

All liabilities of which the taxpayer is relieved in the exchange are offset against all liabilities assumed by the taxpayer in the exchange, regardless of whether the liabilities are recourse or nonrecourse and regardless of whether the liabilities are secured by or otherwise relate to specific property transferred or received as part of the exchange. If there are excess liabilities assumed by the taxpayer as part of the exchange (*i.e.*, the amount of liabilities assumed by the taxpayer exceeds the amount of the liabilities of which the taxpayer is relieved), the excess is allocated to the properties received in all the exchange groups, based on their fair market values and to the extent of their fair market values. The same rules apply if the exchange is part of a larger transaction (*e.g.*, a transaction described in section 1060(a)), except that all liabilities assumed or relieved as part of such larger transaction are offset against each other.

Under certain circumstances, the allocation of excess liabilities assumed to property received in the exchange groups may result in more gain recognized under section 1031 than if the excess liabilities assumed were allocated under another method. For example, this may be the result in the case of a purchase or sale of a business which in part consists of an exchange of multiple properties where there are excess liabilities assumed as part of the overall transaction. On the other hand, the effect of offsetting all liabilities assumed by the taxpayer against all liabilities of which the taxpayer is relieved is generally to decrease the amount of gain recognized.

These proposed rules are intended to preserve consistency between these proposed regulations and existing §1.1031(d)-2, which provides in part that consideration received in the form of money or other property is not offset by consideration given in the form of an assumption of liabilities (or the receipt of property subject to a liability). Comments are requested on ways the operation of the rules regarding the treatment of liabilities may be improved, including comments regarding whether and how existing §1.1031(d)-2 should be modified.

Simplification

In drafting these proposed regulations, consideration has been given to ways in which the operation of underlying rules could be simplified. For example, the proposed regulations treat personal property as being of a like class based on published classification systems, rather than on descriptive rules of less certain application.

A major simplifying provision also appears in the treatment of an exchange of multiple properties. There, rather than requiring taxpayers to compute gain and basis property-by-property, taxpayers are permitted to group properties together. In addition, the allocation of a portion of "other property and money" among exchange groups in order to equalize the aggregate fair market value of the properties transferred and the aggregate fair market value of the properties received in each exchange group often could require detailed prorations and numerous mathematical steps in determining the amount of gain recognized and the basis of the property received in the exchange. However, the same answers can be obtained through a consolidation of a number of the mathematical steps if, as the proposed regulations presume, the net fair market value of the properties transferred by the taxpayer is equal to the net fair market value of the properties received by the taxpayer in the exchange. Therefore, as a means of simplification, the proposed regulations provide that the gain realized with respect to each

exchange group is calculated with reference to the aggregate fair market value of the properties transferred within that exchange group, rather than requiring an actual allocation of a portion of each item of "other property or money" to each exchange group as necessary to equalize the amount received and the amount transferred within that group. As a result, the computations of gain recognized and basis may be made on an aggregate basis within each exchange group.

Comments are requested on other ways in which the proposed regulations could be further clarified or simplified.

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted, consideration will be given to any written comments that are submitted (preferably a signed original and seven copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing will be scheduled and held upon written request by any person who submits written comments on the proposed rules. Notice of the time and place for the hearing will be published in the Federal Register.

List of Subjects

26 CFR 1.1001-1 through 1.1102-3

Basis, Gain and loss, Income taxes, Nontaxable exchanges.

Proposed Amendments to the Regulations

The proposed amendments to 26 CFR, Chapter I, Part 1 are as follows:

PART 1 — INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805 * * *.

Par. 2. Section 1.1031(a)-1(b) is amended by adding a new sentence at the end thereof to read as follows:

§1.1031(a)-1 Property held for productive use in trade or business or for investment.

* * * * *

(b) * * * For additional rules for exchanges of personal property, see §1.1031(a)-2.

Par. 3. Section 1.1031(a)-2 is added immediately following §1.1031(a)-1 to read as follows:

§1.1031(a)-2 Additional rules for exchanges of personal property.

(a) *Introduction.* Section 1.1031(a)-1(b) provides that the nonrecognition rules of section 1031 do not apply to an exchange of one kind or class of property for property of a different kind or class. This section contains additional rules for determining whether personal property has been exchanged for property of a like kind or like class. An exchange of properties of a like kind may qualify under section 1031 regardless of whether the properties are also of a like class. This section provides that personal property of a like class also meets the definition of "like kind" for purposes of section 1031. Under paragraph (b) of this section, depreciable tangible personal properties held for productive use in a business are of a like class if they are either within the same General Business Asset Class (as defined in paragraph (b)(2) of this section) or within the same Product Class (as defined in paragraph (b)(3) of this section). Paragraph (c) of this section provides rules for exchanges of intangible personal property, nondepreciable personal property, and personal property held for investment.

(b) *Depreciable tangible personal property*—(1) *General rule.* Depreciable tangible personal property held for productive use in a business is exchanged for property of a "like kind" under section 1031 if the property is exchanged for property of a like kind or like class. Except as provided in paragraph (b)(4) of this section, depreciable tangible personal property held by the taxpayer for productive use in its business is of a like class to other depreciable tangible personal property to be held by the taxpayer for productive use in its business if the exchanged properties are either within the same General Business Asset Class or within the same Product Class. For purposes of this section, with respect to a transaction, a single property may not be classified within more than one General Business Asset Class or within more than one Product Class. In addition, property within any General Business Asset Class may not be classified within a Product Class. For purposes of this section, a property's General Business Asset Class or Product Class is determined as of the date of the exchange.

(2) *General Business Asset Classes.* Property within a General Business Asset Class consists of depreciable tangible personal property described in one of asset classes 00.11 through 00.28 and 00.4 of Rev. Proc. 87-56, 1987-2 C.B. 674, as modified. These General Business Asset Classes describe types of depreciable tangible personal property that frequently are used in many businesses. The General Business Asset Classes are as follows:

(i) Office furniture, fixtures, and equipment (asset class 00.11),

(ii) Information systems (computers and peripheral equipment) (asset class 00.12),

(iii) Data handling equipment, except computers (asset class 00.13),

(iv) Airplanes (airframes and engines), except those used in commercial or contract carrying of passengers or freight, and all helicopters (airframes and engines) (asset class 00.21),

(v) Automobiles, taxis (asset class 00.22),

(vi) Buses (asset class 00.23),

(vii) Light general purpose trucks (asset class 00.241),

(viii) Heavy general purpose trucks (asset class 00.242),

(ix) Railroad cars and locomotives, except those owned by railroad transportation companies (asset class 00.25),

(x) Tractor units for use over-the-road (asset class 00.26),

(xi) Trailers and trailer-mounted containers (asset class 00.27),

(xii) Vessels, barges, tugs, and similar water-transportation equipment, except those used in marine construction (asset class 00.28), and

(xiii) Industrial steam and electric generation and/or distribution systems (asset class 00.4).

(3) *Product Classes.* Except as provided in paragraph (b)(4) of this section, property within a Product Class consists of depreciable tangible personal property that is listed in a Product Code. A property's Product Code is its 5-digit product class under the product coding system of the U.S. Department of Commerce, Bureau of the Census, 1987 Census of Manufactures and Census of Mineral Industries, 1989 Reference Series: *Numerical List of Manufactured and Mineral Products (Issued February 1989).* (The fifth digit of a product class may be either a letter or a numeral.) For example, construction machinery is listed in Product Codes 3531A through 3531M. An excavator and a power crane are within the same Product Class (and, therefore, are of a like class) because neither property is within a General Business Asset Class and both properties are listed in Product Code 3531E. However, an excavator and a mixer are not of a like class because neither property is within a General Business Asset Class and the properties are not within the same Product Class (*i.e.*, excavators are listed in Product Code 3531E, while mixers are listed in Product Code 3531F). Product Classes are limited to Product Codes that list depreciable tangible personal property. For purposes of this section, if a property is listed in more than one Product Code, the property shall be treated as listed in any one of such Product Codes.

(4) *Property not listed in a Product Code or listed in a miscellaneous Product Code.* In the case of depreciable tangible personal property that is not listed in a Product Code or if the Product Code of such property is a miscellaneous category (*e.g.*, most Product Codes ending in a "9" are miscellaneous categories), the determination of whether the exchanged properties are of a like class is made based on all the facts and circumstances.

(5) *Rev. Proc. 87-56 and Product Codes.* The asset classes of Rev. Proc. 87-56 and the Product Codes of the *Numerical List of Manufactured and Mineral Products* may be updated or modified from time to time. In such event, the General Business Asset Classes and the Product Classes of exchanged property will, to the extent possible, follow the respective successors of Rev. Proc. 87-56 and the *Numerical List of Manufactured and Mineral Products*, unless otherwise provided by the Commissioner. The rules provided in this section concerning the use of Rev. Proc. 87-56 and the *Numerical List of Manufactured and Mineral Products* are limited to exchanges under section 1031. No inference is intended with respect to the classification of property for other purposes, such as depreciation.

(6) *Examples.* The application of this paragraph (b) may be illustrated by the following examples:

Example (1). Taxpayer A transfers a personal computer (asset class 00.12) that A has held for productive use in its business to B in exchange for a printer (asset class 00.12) that A will hold for productive use in its business. With respect to A, the properties exchanged are within the same General Business Asset Class and therefore are of a like class.

Example (2). Taxpayer C transfers an airplane (asset class 00.21) that C has held for productive use in its business to D in exchange for a heavy general purpose truck (asset class 00.242) that C will hold for productive use in its business. The properties exchanged are not of a like class because they are within different General Business Asset Classes. Because each of the properties is within a General Business Asset Class, the properties may not be classified within a Product Class. The airplane and heavy general purpose truck are also not of a like kind. Therefore, the exchange does not qualify for nonrecognition of gain or loss under section 1031.

Example (3). Taxpayer E transfers a grader that E has held for productive use in its business to F in exchange for a scraper that E will hold for productive use in its business. Neither property is within any of the General Business Asset Classes, and both properties are listed in Product Code 3531G. With respect to E, the properties exchanged are within the same Product Class and therefore are of a like class.

Example (4). Taxpayer G transfers a personal computer (asset class 00.12), an airplane (asset class 00.21) and a sanding machine (listed in Product Code 35533), all of which G has held for productive use in its business, to H in exchange for a printer (asset class 00.12), a heavy general purpose truck (asset class 00.242) and a lathe (listed in Product Code 35533), all of which G will hold for productive use in its business. With respect to G, the personal computer and the printer are of a like class because they are within the same General Business Asset Class; the sanding machine and the lathe are of a like class because neither property is within any of the General Business Asset Classes and they are within the same Product Class. The airplane and the heavy general purpose truck are neither within the same General Business Asset Class nor within the same Product Class, and are not of a like kind.

(c) *Intangible personal property, nondepreciable personal property, and personal property held for investment*—(1) *General rule.* An exchange of intangible personal property, nondepreciable personal property, or personal property held for investment does not qualify for nonrecognition of gain or loss under section 1031 if the exchanged properties are not of a like kind. No like classes are provided for such property. Whether intangible personal property is of a like kind to other intangible personal property generally depends not only on the type of right involved (*e.g.*, a patent or a copyright) but also on the type of underlying property to which the intangible personal property relates.

(2) *Special rules for goodwill or going concern value.* The goodwill or going concern value of dissimilar businesses are not of a like kind. The goodwill or going concern value of similar businesses are treated as of a like kind only in rare and unusual circumstances.

(3) *Examples.* The application of this paragraph (c) may be illustrated by the following examples:

Example (1). Taxpayer K exchanges a copyright on a novel for a copyright on a different novel. The properties exchanged are of a like kind.

Example (2). Taxpayer J exchanges a copyright on a novel for a copyright on a song. The properties exchanged are not of a like kind.

Example (3). Taxpayer M exchanges all of the assets of his laundry business for all of the assets of N's laundry business. The exchanged assets include the goodwill of each business. The laundries are in the same city and both provide dry cleaning and laundry services to local customers. M and N have each spent several years working in their respective laundries. Because there is no evidence of rare or unusual circumstances relating to the goodwill of the exchanged laundries, the exchange of goodwill is not an exchange of property of a like kind.

Par. 4. Section 1.1031(b)-1(c) is amended by adding a new sentence after the second sentence thereof to read as follows:

§1.1031(b)-1 Receipt of other property or money in tax-free exchange.

* * * * *

(c) * * * The preceding sentence shall not apply to the extent of any liabilities incurred by the taxpayer in anticipation of an exchange under section 1031.

Par. 5. Section 1.1031(f)-1 is added immediately following §1.1031(e)-1 to read as follows:

§1.1031(f)-1 Exchanges of multiple properties.

(a) *Introduction*—(1) *Overview.* As a general rule, the application of section 1031 requires a property-by-property comparison for computing the gain recognized and basis of property received in a like-kind exchange. This section provides an exception to this general rule in the case of an exchange of multiple properties. An exchange is an exchange of multiple properties if, under paragraph (b)(2) of this section, more than one exchange group is created. Paragraph (b) of this section provides rules for computing the amount of gain recognized in an exchange of multiple properties qualifying for nonrecognition of gain or loss under section 1031. Paragraph (c) of this section provides rules for computing the basis of properties received in an exchange of multiple properties qualifying for nonrecognition of gain or loss under section 1031.

(2) *General Approach.* In general, the amount of gain recognized in an exchange of multiple properties is computed by first separating the properties transferred and the properties received by the taxpayer in the exchange into exchange groups in the manner described in paragraph (b)(2) of this section. Next, all liabilities assumed by the taxpayer as part of the exchange are offset by all liabilities of which the taxpayer is relieved as part of the exchange, with the excess liabilities assumed or relieved allocated in accordance with paragraph (b)(2)(ii) of this section. Then, the rules of section 1031 and the regulations thereunder are applied separately to each exchange group to determine the amount of gain recognized in the exchange. See §§1.1031(b)-1 and 1.1031(c)-1. Finally, the rules of section 1031 and the regulations thereunder are applied separately to each exchange group to determine the basis of the properties received in the exchange. See §§1.1031(d)-1 and 1.1031(d)-2. The separation of the properties transferred and the properties received in the exchange into exchange groups involves matching up properties of a like kind or like class to the extent possible. For purposes of this section, the exchanges are assumed to be made at arms' length, and there is a presumption that the amount realized with respect to the properties transferred in each exchange group equals their aggregate fair market value. As a result of this presumption, the rules provided in paragraphs (b) and (c) of this section are based upon a deemed allocation of property and money among the exchange groups to the extent necessary to equalize the aggregate fair market value of the properties transferred and the aggregate fair market value of the properties received within each exchange group.

(b) *Computation of gain recognized*—(1) *In general.* In computing the amount of gain recognized in an exchange of multiple properties, the fair market value must be determined for each property transferred and for each property received by the taxpayer in the exchange and the adjusted basis must be determined for each property transferred by the taxpayer in the exchange.

(2) *Exchange groups and residual group.* The properties transferred and the properties received by the taxpayer in the exchange are separated into exchange groups and a residual group in the following manner:

(i) *Exchange groups.* Each exchange group consists of the properties transferred and received in the exchange, all of which are of a like kind or like class. Property eligible for inclusion within an exchange group does not include money or property described in section 1031(a)(2) (*i.e.*, stock in trade or other property held primarily for sale, stocks, bonds, notes, other securities or evidences of indebtedness or interest, interests in a partnership, certificates of trust or beneficial interests, or choses in action). For example, an exchange group may consist of all exchanged properties that are within the same General Business Asset Class or within the same Product Class (as defined in §1.1031(a)-2(b)). Each exchange group must consist of at least one property transferred and at least one property received in the exchange.

(ii) *Treatment of liabilities.* (A) All liabilities assumed by the taxpayer as part of the exchange are offset against all liabilities of which the taxpayer is relieved as part of the exchange, regardless of whether such liabilities are recourse or nonrecourse and regardless of whether such liabilities are secured by or otherwise relate to specific property transferred or received as part of the exchange. See §§1.1031(b)-1(c) and 1.1031(d)-2. For purposes of this section, liabilities assumed by the taxpayer as part of the exchange consist of liabilities of the other party to the exchange assumed by the taxpayer and liabilities subject to which the other party's property is transferred in the exchange. Similarly, liabilities of which the taxpayer is relieved as part of the exchange consist of liabilities of the taxpayer assumed by the other party to the exchange and liabilities subject to which the taxpayer's property is transferred.

(B) If there are excess liabilities assumed by the taxpayer as part of the exchange (*i.e.*, the amount of liabilities assumed by the taxpayer exceeds the amount of liabilities of which the taxpayer is relieved), such excess is allocated among the exchange groups (but not to the residual group) in proportion to the aggregate fair market value of the properties received by the taxpayer in the exchange groups. The amount of excess liabilities assumed by the taxpayer that are allocated to each exchange group may not exceed the aggregate fair market value of the properties received in the exchange group.

(C) If there are excess liabilities of which the taxpayer is relieved as part of the exchange (*i.e.*, the amount of liabilities of which the taxpayer is relieved exceeds the amount of liabilities assumed by the taxpayer), such excess is allocated to the residual group to the extent such excess would be so allocated if it were treated as a Class I asset for purposes of paragraph (b)(2)(iii) of this section.

(D) Paragraph (b)(2)(ii)(A), (B), and (C) of this section shall be applied in the same manner even if section 1031 and this section apply to

only a portion of a larger transaction (such as a transaction described in section 1060(c) and §1.1060-1T(b)). In such event, the amount of excess liabilities assumed by the taxpayer or the amount of excess liabilities of which the taxpayer is relieved shall be determined based on all liabilities assumed by the taxpayer and all liabilities of which the taxpayer is relieved as part of such larger transaction.

(iii) *Residual group.* A residual group is created consisting of money or property that is not subject to the nonrecognition provisions of section 1031. For this purpose, property includes property described in section 1031(a)(2) (*i.e.*, stock in trade or other property held primarily for sale, stocks, bonds, notes, other securities or evidences of indebtedness or interest, interests in a partnership, certificates of trust or beneficial interests, or choses in action), property transferred that is not of a like kind or like class with any property received, and property received that is not of a like kind or like class with any property transferred. The amount of money or property allocated to the residual group is equal to the difference between the aggregate fair market value of the properties transferred in all of the exchange groups and the aggregate fair market value of the properties received in all of the exchange groups (taking liabilities into account in the manner described in paragraph (b)(2)(ii) of this section). In general, the residual group will consist of either money or property transferred in the exchange or money or property received in the exchange, but not both. The money and properties that are allocated to the residual group are considered to come from the following assets in the following order: first from Class I assets, then from Class II assets, then from Class III assets, and then from Class IV assets. The terms Class I assets, Class II assets, Class III assets, and Class IV assets have the same meanings as in §1.1060-1T(d). Within each Class, taxpayers may choose which properties are allocated to the residual group.

(iv) *Exchange group surplus and deficiency.* For each of the exchange groups described in this section, an "exchange group surplus" or an "exchange group deficiency," if any, must be determined. An exchange group surplus is the excess of the aggregate fair market value of the properties received (less the amount of any excess liabilities assumed by the taxpayer that are allocated to that exchange group) in an exchange group over the aggregate fair market value of the properties transferred in such exchange group. An exchange group deficiency is the excess of the aggregate fair market value of the properties transferred in an exchange group over the aggregate fair market value of the properties received (less the amount of any excess liabilities assumed by the taxpayer that are allocated to that exchange group) in such exchange group.

(3) *Amount of gain recognized.* (i) For purposes of this section, the amount of gain or loss realized with respect to each exchange group and the residual group is the difference between the aggregate fair market value of the properties transferred in that exchange group or residual group and the properties' aggregate adjusted basis. The gain realized with respect to each exchange group is recognized to the extent of the lesser of the gain realized and the amount of the exchange group deficiency, if any. Losses realized with respect to an exchange group are not recognized. See section 1031(a) and (c). The total amount of gain recognized under section 1031 in the exchange is the sum of the amount of gain recognized with respect to each exchange group. With respect to the residual group, the gain or loss realized (as determined under this section) is recognized as provided in section 1001 or other applicable provision of the Code.

(ii) The amount of gain or loss realized and recognized with respect to properties transferred by the taxpayer that are not within any exchange group or the residual group is determined under section 1001 and other applicable provisions of the Code, with proper adjustments made for all liabilities not allocated to the exchange groups or the residual group.

(c) *Computation of basis of properties received.* In an exchange of multiple properties qualifying for nonrecognition of gain or loss under section 1031 and this section, the aggregate basis of properties received in each of the exchange groups is the aggregate adjusted basis of the properties transferred by the taxpayer within that exchange group, increased by the amount of gain recognized by the taxpayer with respect to that exchange group, increased by the amount of the exchange group surplus or decreased by the amount of the exchange group deficiency, and increased by the amount, if any, of excess liabilities assumed by the taxpayer that are allocated to that exchange group. The resulting aggregate basis of each exchange group is allocated proportionately to each property received in the exchange group in accordance with its fair market value. The basis of each property received within the residual group (other than money) is equal to its fair market value in accordance with section 1012 or other applicable provision of the Code.

(d) *Examples.* The application of this section may be illustrated by the following examples:

Example (1). (i) K exchanges computer A (asset class 00.12) and automobile A (asset class 00.22), both of which were held by K for productive use in its business, with W for printer B (asset class 00.12) and automobile B (asset class 00.22), both of which will be held by K for productive use in its business. K's adjusted basis and the fair market value of the exchanged properties are as follows:

	Adjusted Basis	*Fair Market Value*
Computer A	$ 375	$1000
Automobile A	1500	4000
Printer B	- - -	2050
Automobile B	- - -	2950

(ii) Under paragraph (b)(2) of this section, the properties exchanged are separated into exchange groups as follows:

(A) The first exchange group consists of computer A and printer B (both are within the same General Business Asset Class) and, as to K, has an exchange group surplus of $1050 because the fair market value of printer B ($2050) exceeds the fair market value of computer A ($1000) by that amount.

(B) The second exchange group consists of automobile A and automobile B (both are within the same General Business Asset Class) and, as to K, has an exchange group deficiency of $1050 because the fair market value of automobile A ($4000) exceeds the fair market value of automobile B ($2950) by that amount.

(iii) K recognizes gain on the exchange as follows:

(A) With respect to the first exchange group, the amount of gain realized is the excess of the fair market value of computer A ($1000) over its adjusted basis ($375), or $625. The amount of gain recognized is the lesser of the gain realized ($625) and the exchange group deficiency ($0), or $0.

(B) With respect to the second exchange group, the amount of gain realized is the excess of the fair market value of automobile A ($4000) over its adjusted basis ($1500), or $2500. The amount of gain recognized is the lesser of the gain realized ($2500) and the exchange group deficiency ($1050), or $1050.

(iv) The total amount of gain recognized by K in the exchange is the sum of the gains recognized with respect to both exchange groups ($0 + $1050), or $1050.

(v) The bases of the property received by K in the exchange, printer B and automobile B, are determined in the following manner:

(A) The basis of the property received in the first exchange group is the adjusted basis of the property transferred within that exchange group ($375), increased by the amount of gain recognized with respect to that exchange group ($0), increased by the amount of the exchange group surplus ($1050), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $1425. Because printer B was the only property received within the first exchange group, the entire basis of $1425 is allocated to printer B.

(B) The basis of the property received in the second exchange group is the adjusted basis of the property transferred within that exchange group ($1500), increased by the amount of gain recognized with respect to that exchange group ($1050), decreased by the amount of the exchange group deficiency ($1050), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $1500. Because automobile B was the only property received within the second exchange group, the entire basis of $1500 is allocated to automobile B.

Example (2). (i) F exchanges computer A (asset class 00.12) and automobile A (asset class 00.22), both of which were held by F for productive use in its business, with G for printer B (asset class 00.12) and automobile B (asset class 00.22), both of which will be held by F for productive use in its business, and corporate stock and $500 cash. The adjusted basis and fair market value of the properties are as follows:

	Adjusted Basis	*Fair Market Value*
Computer A	$ 375	$1000
Automobile A	3500	4000
Printer B	- - -	800
Automobile B	- - -	2950
Corporate Stock	- - -	750
Cash		500

(ii) Under paragraph (b)(2) of this section, the properties exchanged are separated into exchange groups as follows:

(A) The first exchange group consists of computer A and printer B (both are within the same General Business Asset Class) and, as to F, has an exchange group deficiency of $200 because the fair market value of computer A ($1000) exceeds the fair market value of printer B ($800) by that amount.

(B) The second exchange group consists of automobile A and automobile B (both are within the same General Business Asset Class) and, as to F, has an exchange group deficiency of $1050 because the fair market value of automobile A ($4000) exceeds the fair market value of automobile B ($2950) by that amount.

(C) Because the aggregate fair market value of the properties transferred by F in the exchange groups ($5,000) exceeds the aggregate fair market value of the properties received by F in the exchange groups ($3,750) by $1,250, there is a residual group in that amount consisting of the $500 cash and the $750 worth of corporate stock.

(iii) F recognizes gain on the exchange as follows:

(A) With respect to the first exchange group, the amount of gain realized is the excess of the fair market value of computer A ($1000) over its adjusted basis ($375), or $625. The amount of gain recognized is the lesser of the gain realized ($625) and the exchange group deficiency ($200), or $200.

(B) With respect to the second exchange group, the amount of gain realized is the excess of the fair market value of automobile A ($4000) over its adjusted basis ($3500), or $500. The amount of gain recognized is the lesser of the gain realized ($500) and the exchange group deficiency ($1050), or $500.

(C) No property transferred by F was allocated to the residual group. Therefore, F does not recognize gain or loss with respect to the residual group.

(iv) The total amount of gain recognized by F in the exchange is the sum of the gains recognized with respect to both exchange groups ($200 + $500), or $700.

(v) The bases of the properties received by F in the exchange (printer B, automobile B, and the corporate stock) are determined in the following manner:

(A) The basis of the property received in the first exchange group is the adjusted basis of the property transferred within that exchange group ($375), increased by the amount of gain recognized with respect to that exchange group ($200), decreased by the amount of the exchange group deficiency ($200), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $375. Because printer B was the only property received within the first exchange group, the entire basis of $375 is allocated to printer B.

(B) The basis of the property received in the second exchange group is the adjusted basis of the property transferred within that exchange group ($3500), increased by the amount of gain recognized with respect to that exchange group ($500), decreased by the amount of the exchange group deficiency ($1050), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $2950. Because automobile B was the only property received within the second exchange group, the entire basis of $2950 is allocated to automobile B.

(C) The basis of the property received within the residual group (the corporate stock) is equal to its fair market value or $750. Cash of $500 is also received within the residual group.

Example (3). (i) J and H enter into an exchange of the following properties. All of the property (except for the inventory) transferred by J was held for productive use in J's business. All of the property received by J will be held by J for productive use in its business.

J Transfers:			*H Transfers:*	
Property	*Adjusted Basis*	*Fair Market Value*	*Property*	*Fair Market Value*
Computer A	$1500	$5000	Computer Z	$4500
Computer B	500	3000	Printer Y	2500
Printer C	2000	1500	Real Estate X	1000
Real Estate D	1200	2000	Real Estate W	4000
Real Estate E	0	1800	Grader V	2000
Scraper F	3300	2500	Truck T	1700
Inventory	1000	1700	Cash	1800
Total	$9500	$17,500		$17,500

(ii) Under paragraph (b)(2) of this section, the properties exchanged are separated into exchange groups as follows:

(A) The first exchange group consists of computer A, computer B, printer C, computer Z, and printer Y (all are within the same General Business Asset Class) and, as to J, has an exchange group deficiency of $2500 (($5000 + $3000 + $1500) - ($4500 + $2500)).

(B) The second exchange group consists of real estate D, E, X and W (all are of a like kind) and, as to J, has an exchange group surplus of $1200 (($1000 + $4000) - ($2000 + $1800)).

(C) The third exchange group consists of scraper F and grader V (both are listed in Product Code 3531G and thus are within the same Product Class) and, as to J, has an exchange group deficiency of $500 ($2500 - $2000).

(D) Because the aggregate fair market value of the properties transferred by J in the exchange groups ($15,800) exceeds the aggregate fair market value of the properties received by J in the exchange groups ($14,000) by $1,800, there is a residual group in that amount consisting of the $1800 cash (a Class I asset).

(E) The transaction also includes a taxable exchange of inventory for truck T (which is not of a like kind or like class to any property transferred in the exchange).

(iii) J recognizes gain on the transaction as follows:

(A) With respect to the first exchange group, the amount of gain realized is the excess of the aggregate fair market value of the properties

transferred in the exchange group ($9500) over the aggregate adjusted basis ($4000), or $5500. The amount of gain recognized is the lesser of the gain realized ($5500) and the exchange group deficiency ($2500), or $2500.

(B) With respect to the second exchange group, the amount of gain realized is the excess of the aggregate fair market value of the properties transferred in the exchange group ($3800) over the aggregate adjusted basis ($1200), or $2600. The amount of gain recognized is the lesser of the gain realized ($2600) and the exchange group deficiency ($0), or $0.

(C) With respect to the third exchange group, a loss is realized in the amount of $800 because the fair market value of the property transferred in the exchange group ($2500) is less than its adjusted basis ($3300). Although a loss of $800 was realized, under section 1031 (a) and (c) losses are not recognized.

(D) No property transferred by J was allocated to the residual group. Therefore, J does not recognize gain or loss with respect to the residual group.

(E) With respect to the taxable exchange of inventory for truck T, gain of $700 is realized and recognized by J (amount realized of $1700 (the fair market value of truck T) less the adjusted basis of the inventory ($1000)).

(iv) The total amount of gain recognized by J in the transaction is the sum of the gains recognized under section 1031 with respect to each exchange group ($2500 + $0 + $0) and any gain recognized outside of section 1031 ($700), or $3200.

(v) The bases of the property received by J in the exchange are determined in the following manner:

(A) The aggregate basis of the properties received in the first exchange group is the adjusted basis of the properties transferred within that exchange group ($4000), increased by the amount of gain recognized with respect to that exchange group ($2500), decreased by the amount of the exchange group deficiency ($2500), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $4000. This $4000 of basis is allocated proportionately among the assets received within the first exchange group in accordance with their fair market values: computer Z's basis is $2571 ($4000 x $4500/$7000); printer Y's basis is $1429 ($4000 x $2500/$7000).

(B) The aggregate basis of the properties received in the second exchange group is the adjusted basis of the properties transferred within that exchange group ($1200), increased by the amount of gain recognized with respect to that exchange group ($0), increased by the amount of the exchange group surplus ($1200), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $2400. This $2400 of basis is allocated proportionately among the assets received within the second exchange group in accordance with their fair market values: real estate X's basis is $480 ($2400 x $1000/$5000); real estate W's basis is $1920 ($2400 x $4000/$5000).

(C) The basis of the property received in the third exchange group is the adjusted basis of the property transferred within that exchange group ($3300), increased by the amount of gain recognized with respect to that exchange group ($0), decreased by the amount of the exchange group deficiency ($500), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $2800. Because grader V was the only property received within the third exchange group, the entire basis of $2800 is allocated to grader V.

(D) Cash of $1800 is received within the residual group.

(E) The basis of the property received in the taxable exchange (truck T) is equal to its cost of $1,700.

Example (4). (i) B exchanges computer A (asset class 00.12), automobile A (asset class 00.22) and truck A (asset class 00.241), with C for computer R (asset class 00.12), automobile R (asset class 00.22), truck R (asset class 00.241) and $400 cash. All properties transferred by either B or C were held for productive use in the respective transferor's business. Similarly, all properties to be received by either B or C will be held for productive use in the respective recipient's business. Automobile A, automobile R and truck R are each secured by a nonrecourse liability and are transferred subject to such liability. The adjusted basis, fair market value, and liability secured by each property, if any, are as follows:

	Adjusted Basis	*Fair Market Value*	*Liability*
B Transfers:			
Computer A	$800	$1500	$ 0
Automobile A	900	2500	500
Truck A	700	2000	0
C Transfers:			
Computer R	$1100	$1600	$ 0
Automobile R	2100	3100	750
Truck R	600	1400	250
Cash		400	

(ii) The tax treatment to B is as follows:

(A)(*1*) The first exchange group consists of computers A and R (both are within the same General Business Asset Class).

(*2*) The second exchange group consists of automobiles A and R (both are within the same General Business Asset Class).

(*3*) The third exchange group consists of trucks A and R (both are in the same General Business Asset Class).

(B) Under paragraph (b)(2)(ii) of this section, all liabilities assumed by B ($1000) are offset by all liabilities of which B is relieved ($500), resulting in excess liabilities assumed of $500. The excess liabilities assumed of $500 is allocated among the exchange groups in proportion to the fair market value of the properties received by B in the exchange groups as follows:

(*1*) $131 of excess liabilities assumed ($500 x $1600/$6100) is allocated to the first exchange group. The first exchange group has an exchange group deficiency of $31 because the fair market value of computer A ($1500) exceeds the fair market value of computer R less the excess liabilities assumed allocated to the exchange group ($1600 − $131) by that amount.

(*2*) $254 of excess liabilities assumed ($500 x $3100/$6100) is allocated to the second exchange group. The second exchange group has an exchange group surplus of $346 because the fair market value of automobile R less the excess liabilities assumed allocated to the exchange group ($3100 − $254) exceeds the fair market value of automobile A ($2500) by that amount.

(*3*) $115 of excess liabilities assumed ($500 x $1400/$6100) is allocated to the third exchange group. The third exchange group has an exchange group deficiency of $715 because the fair market value of truck A ($2000) exceeds the fair market value of truck R less the excess liabilities assumed allocated to the exchange group ($1400 − $115) by that amount.

(*4*) The difference between the aggregate fair market value of the properties transferred in all of the exchange groups, $6000, and the aggregate fair market value of the properties received in all of the exchange groups (taking excess liabilities assumed into account), $5600, is $400. Therefore there is a residual group in that amount consisting of $400 cash received.

(C) B recognizes gain on the exchange as follows:

(*1*) With respect to the first exchange group, the amount of gain realized is the excess of the fair market value of computer A ($1500) over its adjusted basis ($800), or $700. The amount of gain recognized is the lesser of the gain realized ($700) and the exchange group deficiency ($31), or $31.

(*2*) With respect to the second exchange group, the amount of gain realized is the excess of the fair market value of automobile A ($2500) over its adjusted basis ($900), or $1600. The amount of gain recognized is the lesser of the gain realized ($1600) and the exchange group deficiency ($0), or $0.

(*3*) With respect to the third exchange group, the amount of gain realized is the excess of the fair market value of truck A ($2000) over its adjusted basis ($700), or $1300. The amount of gain recognized is the lesser of gain realized ($1300) and the exchange group deficiency ($715), or $715.

(*4*) No property transferred by B was allocated to the residual group. Therefore, B does not recognize gain or loss with respect to the residual group.

(D) The total amount of gain recognized by B in the exchange is the sum of the gains recognized under section 1031 with respect to each exchange group ($31 + $0 + $715), or $746.

(E) The bases of the property received by B in the exchange (computer R, automobile R, and truck R) are determined in the following manner:

(*1*) The basis of the property received in the first exchange group is the adjusted basis of the property transferred within that exchange group ($800), increased by the amount of gain recognized with respect to that exchange group ($31), decreased by the amount of the exchange group deficiency ($31), and increased by the amount of excess liabilities assumed allocated to that exchange group ($131), or $931. Because computer R was the only property received within the first exchange group, the entire basis of $931 is allocated to computer R.

(2) The basis of the property received in the second exchange group is the adjusted basis of the property transferred within that exchange group ($900), increased by the amount of gain recognized with respect to that exchange group ($0), increased by the amount of the exchange group surplus ($346), and increased by the amount of excess liabilities assumed allocated to that exchange group ($254), or $1500. Because automobile R was the only property received within the second exchange group, the entire basis of $1500 is allocated to automobile R.

(3) The basis of the property received in the third exchange group is the adjusted basis of the property transferred within that exchange group ($700), increased by the amount of gain recognized with respect to that exchange group ($715), decreased by the amount of the exchange group deficiency ($715), and increased by the amount of excess liabilities assumed allocated to that exchange group ($115), or $815. Because truck R was the only property received within the third exchange group, the entire basis of $815 is allocated to truck R.

(F) Cash of $400 is also received by B.

(iii) The tax treatment to C is as follows:

(A)(1) The first exchange group consists of computers R and A (both are within the same General Business Asset Class).

(2) The second exchange group consists of automobiles R and A (both are within the same General Business Asset Class).

(3) The third exchange group consists of trucks R and A (both are in the same General Business Asset Class).

(B) Under paragraph (b)(2)(ii) of this section, all liabilities of which C is relieved ($1000) are offset by all liabilities assumed by C ($500), resulting in excess liabilities relieved of $500. This excess liabilities relieved is treated as cash received by C.

(1) The first exchange group has an exchange group deficiency of $100 because the fair market value of computer R ($1600) exceeds the fair market value of computer A ($1500) by that amount.

(2) The second exchange group has an exchange group deficiency of $600 because the fair market value of automobile R ($3100) exceeds the fair market value of automobile A ($2500) by that amount.

(3) The third exchange group has an exchange group surplus of $600 because the fair market value of truck A ($2000) exceeds the fair market value of truck R ($1400) by that amount.

(4) The difference between the aggregate fair market value of the properties transferred by C in all of the exchange groups, $6100, and the aggregate fair market value of the properties received by C in all of the exchange groups, $6000, is $100. Therefore, there is a residual group in that amount, consisting of excess liabilities relieved of $100, which is treated as cash received by C.

(5) The $400 cash paid by C and $400 of the excess liabilities relieved which is treated as cash received by C are not within the exchange groups or the residual group.

(C) C recognizes gain on the exchange as follows:

(1) With respect to the first exchange group, the amount of gain realized is the excess of the fair market value of computer R ($1600) over its adjusted basis ($1100), or $500. The amount of gain recognized is the lesser of the gain realized ($500) and the exchange group deficiency ($100), or $100.

(2) With respect to the second exchange group, the amount of gain realized is the excess of the fair market value of automobile R ($3100) over its adjusted basis ($2100), or $1000. The amount of gain recognized is the lesser of the gain realized ($1000) and the exchange group deficiency ($600), or $600.

(3) With respect to the third exchange group, the amount of gain realized is the excess of the fair market value of truck R ($1400) over its adjusted basis ($600), or $800. The amount of gain recognized is the lesser of gain realized ($800) and the exchange group deficiency ($0), or $0.

(4) No property transferred by C was allocated to the residual group. Therefore, C does not recognize any gain with respect to the residual group.

(D) The total amount of gain recognized by C in the exchange is the sum of the gains recognized under section 1031 with respect to each exchange group ($100 + $600 + $0), or $700.

(E) The bases of the properties received by C in the exchange (computer A, automobile A, and truck A) are determined in the following manner:

(1) The basis of the property received in the first exchange group is the adjusted basis of the property transferred within that exchange group ($1100), increased by the amount of gain recognized with respect to that exchange group ($100), decreased by the amount of the exchange group deficiency ($100), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $1100. Because computer A was the only property received within the first exchange group, the entire basis of $1100 is allocated to computer A.

(2) The basis of the property received in the second exchange group is the adjusted basis of the property transferred within that exchange group ($2100), increased by the amount of gain recognized with respect to that exchange group ($600), decreased by the amount of the exchange group deficiency ($600), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $2100. Because automobile A was the only property received within the second exchange group, the entire basis of $2100 is allocated to automobile A.

(3) The basis of the property received in the third exchange group is the adjusted basis of the property transferred within that exchange group ($600), increased by the amount of gain recognized with respect to that exchange group ($0), increased by the amount of the exchange group surplus ($600), and increased by the amount of excess liabilities assumed allocated to that exchange group ($0), or $1200. Because truck A was the only property received within the third exchange group, the entire basis of $1200 is allocated to truck A.

Fred T. Goldberg, Jr.,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on April 25, 1990, 8:45 a.m., and published in the issue of the Federal Register for April 26, 1990, 55 F.R. 17635)

Notice of Proposed Rulemaking

Adjusted Current Earnings, Foreign Sales Corporations

IA-29-89

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of Proposed Rulemaking.

SUMMARY: This document contains proposed regulations relating to the alternative minimum tax for corporations. The Tax Reform Act of 1986, the Technical and Miscellaneous Revenue Act of 1988, and the Revenue Reconciliation Act of 1989 all made changes to the applicable law. These regulations affect corporate taxpayers and provide them with guidance necessary to determine their alternative minimum tax. This document also contains proposed amendments to the temporary regulations relating to Foreign Sales Corporations.

DATES: These regulations are proposed to be effective for taxable years beginning after 1989. These regulations are proposed to be effective for taxable years beginning after 1989. Written comments must be recieved by August 1, 1990. Outlines for persons wishing to speak at the public hearing scheduled for Tuesday, October 16, 1990, and Wednesday, October 17, 1990, must be received by September 25, 1990. *See* the Notice of Public hearing published in *** [Announcement 90-75, 1990-22 I.R.B. 32].

ADDRESS: The Service will hold the public hearing in the I.R.S. Auditorium, 7th Floor, Internal Revenue Building, 1111 Constitution Ave., N.W., Washington, D.C. Send comments, requests to speak, and the outlines of oral comments to Internal Revenue Service, P. O. Box 7604, Ben Franklin Station, Washington, D.C., 20044, Attention: CC:CORP:T:R (IA-29-89), Room 4429.

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed regulations amending the Income Tax Regulations (26 CFR Part 1) under section 56 of the Internal Revenue

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Code of 1986. The proposed amendments would conform the regulations to section 701 of the Tax Reform Act of 1986 (Public L. 99-514; 100 Stat. 2320) [1986-3 C.B. (Vol.1) 237], sections 1007 and 6079 of the Technical and Miscellaneous Revenue Act of 1988 (Public L. 100-647, 102 Stat. 3342) [1988-3 C.B. 2], and sections 7205 and 7611 of the Revenue Reconciliation Act of 1989 (Public L. 101-239, 103 Stat. 2106) [page 210, this Bulletin].

Adjustment for Adjusted Current Earnings

I. *General description of provisions.*

Section 1.56-1(g) provides rules under which corporate taxpayers subject to the alternative minimum tax of section 55 or environmental tax of section 59A must determine the adjustment to alternative minimum taxable income (AMTI) for adjusted current earnings (ACE). For taxable years beginning after 1989, corporations must increase their AMTI by the adjustment for ACE. This adjustment is equal to 75 percent of the excess, if any, of the ACE of the taxpayer for the taxable year over the pre-adjustment AMTI of the taxpayer for the taxable year. Pre-adjustment AMTI is the AMTI of the taxpayer for the taxable year, determined without the adjustment for ACE and without the alternative tax net operating loss deduction. A taxpayer is allowed a negative adjustment for 75 percent of any excess of pre-adjustment AMTI over ACE, to the extent of the taxpayer's net positive adjustments for ACE in prior taxable years.

ACE is defined in §1.56(g)-1(a)-(5)(ii) as the taxpayer's pre-adjustment AMTI for the taxable year determined by taking into account certain specified adjustments. ACE is designed to be at least as broad a tax base, on a cumulative basis, as is pre-adjustment AMTI. ACE is also designed to be a measure of income that is at least as broad as pre-tax net book income as measured for financial reporting purposes. In certain circumstances where income is defined more broadly for financial reporting purposes than for tax purposes, the financial reporting concepts apply for purposes of computing ACE, in order to tax corporations on income that corresponds to earnings reported to regulators, shareholders, or creditors. In addition, for most purposes, ACE is determined as a separate and independent tax system. Thus, for example, the adjusted basis of property used for purposes of computing ACE is determined by taking into account ACE capitalization and cost recovery requirements.

II. *Earnings and profits as a component of ACE.*

A. *In general.*

As described above, the starting point for determining ACE is the pre-adjustment AMTI of the taxpayer. In addition, §1.56(g)-1(c) provides that ACE generally includes all income items that are taken into account in determining current earnings and profits if the items are not includible in pre-adjustment AMTI. Interest income on tax-exempt obligations is an example of such an income item.

An item generally is not deductible in computing ACE, however, unless it is deductible in determining both pre-adjustment AMTI and current earnings and profits. Thus, an item that is deductible in determining current earnings and profits is not deductible in computing ACE if it is not also deductible in determining pre-adjustment AMTI. In addition, items that are deductible in determining pre-adjustment AMTI must be added back for purposes of computing ACE if they are not also deductible in determining current earnings and profits.

A limited exception to the general disallowance of deductions for items not deductible in determining pre-adjustment AMTI is provided for items that would have been deductible if the income item to which they relate had been included in pre-adjustment AMTI. Under this exception, interest expense on indebtedness incurred to purchase tax-exempt obligations is deductible in computing ACE, because it would have been deductible in determining pre-adjustment AMTI if the tax-exempt interest to which it relates had been included in pre-adjustment AMTI.

B. *Treatment of items not deductible in computing pre-adjustment AMTI.*

Congress intended that ACE be a broader tax base than pre-adjustment AMTI. As a result, the Code provisions applicable to both income items and expense items tend to cause ACE to exceed pre-adjustment AMTI. The rules in the proposed regulations are derived directly from the requirements of the statute. Because ACE comprises a series of explicitly enumerated adjustments to pre-adjustment AMTI, a deduction that is disallowed for pre-adjustment AMTI and is not included in the list of ACE adjustments is not taken into account in computing ACE.

Section 1.56(g)-1(e) provides that amounts that are not deductible in computing pre-adjustment AMTI generally are not deductible in computing ACE, notwithstanding the fact that these amounts may be deductible in computing current earnings and profits. Thus, for example, because net capital losses are not deductible in determining pre-adjustment AMTI, a capital loss is deductible in computing ACE only to the extent of capital gains for the taxable year even though a net capital loss may be deductible for purposes of computing earnings and profits. Similarly, even though these items may be deductible in computing current earnings and profits, no deduction is allowed in computing ACE for bribes, fines, and penalties disallowed under section 162; charitable contributions in excess of the limitations of section 170; expenditures for meals and entertainment in excess of the limitations of section 274; federal taxes disallowed under section 275; and golden parachute payments in excess of the limitation of section 280G.

C. *Treatment of expenses attributable to income taken into account in computing ACE.*

As explained above, a deduction is allowed for expenses attributable to income that is taken into account in computing ACE if those expenses would have been deductible in computing pre-adjustment AMTI had the income that is includible in ACE been includible in pre-adjustment AMTI. The proposed regulations do not limit the amount of the deduction for these expenses to the amount of related income that is included in ACE as of the end of the taxable year. Instead, these expenses may be deducted even if an offsetting amount of related income has not yet been taken into account in determining ACE. This approach relieves taxpayers of the burden of tracking, year-by-year and

item-by-item, both the income items and their offsetting deductions.

D. *Inclusion of buildup in life insurance contracts.*

Section 56(g)(4)(B)(ii) and §1.56(g)-1(c)(5) provide that the undistributed income (inside buildup) for a taxable year on a corporate-owned life insurance contract is included in ACE, and a deduction is allowed for the portion of any premium that is attributable to insurance coverage. In general, the determination of income on the contract for ACE purposes parallels the determination under section 7702(g)(1)(B) for regular tax purposes. The computation generally determines the increase in the net surrender value of the contract. In addition, the computation has been simplified by omitting the inclusion of the cost of the insurance protection in income on the contract and the offsetting deduction for this amount in computing ACE. The Service welcomes suggestions on ways to further simplify the computation of inside buildup.

E. *Treatment of dividend distributions.*

ACE is determined by reference to current earnings and profits within the meaning of section 316(a)(2). This treatment is indicated by the legislative history of the Tax Reform Act of 1986, which states, "Adjusted current earnings measures pre-tax income without diminution by reason of any distribution made during the taxable year . . . [N]o deduction is allowed with respect to a dividend paid." H.R. Rep. No. 841, 99th Cong., 2nd Sess. II-276 (1986). Therefore, under §1.56(g)-1(d) of the proposed regulations, dividend distributions with respect to stock that are deductible in computing pre-adjustment AMTI are not deductible in computing ACE. Thus, for example, ACE is determined without taking into account deductions allowed under sections 247 (dividends paid by public utilities with respect to certain preferred stock), 404(k) (certain dividends paid with respect to stock held by an employee stock ownership plan), and 1382(c) (nonpatronage dividends paid by certain cooperatives).

In contrast, deductible distributions that are labeled "dividends," but that are not made with respect to stock, are not treated as dividends under section 301(a) and do reduce current earnings and profits for purposes of determining the amount available for distribution as a dividend. These distributions are deductible in computing both pre-adjustment AMTI and ACE. Therefore, for example, no adjustment to ACE is required for dividends paid on deposits by thrift institutions deductible under section 591, life insurance policyholder dividends deductible under section 808, and patronage dividends of cooperatives deductible under section 1382(b).

The treatment of dividends in the proposed regulations is consistent with the manner in which current earnings and profits are computed by a corporation in determining the amount available for distribution as a dividend under section 301(a). For example, a stock life insurance company that pays a policyholder dividend reduces current earnings and profits by the amount of that dividend in determining the extent to which a distribution with respect to its stock constitutes a dividend as opposed to a return of capital. In contrast, a distribution made by a stock life insurance company with respect to its stock held by an employee stock ownership plan does not reduce current earnings and profits in determining whether that distribution and other distributions with respect to the corporation's stock constitute a dividend as opposed to a return of capital. This is true even though the dividend may be deductible for regular tax purposes under section 404(k). This treatment of dividends is also consistent with Congress' intent that ACE not be less than the amount of current earnings and profits and pre-tax net book income for the taxable year that is available for distribution to shareholders.

F. *Treatment of timing differences.*

Section 1.56(g)-1(c)(1) provides that ACE includes all income items that are permanently excluded from pre-adjustment AMTI but are taken into account in determining current earnings and profits. The proposed regulations clarify, however, that an income item may be considered permanently excluded from pre-adjustment AMTI even though the proceeds from that item might eventually be reflected in pre-adjustment AMTI of another taxpayer upon the liquidation or disposal of a business. Under the proposed regulations, ACE is generally determined by using the income timing rules applicable in computing pre-adjustment AMTI even if an income item is taken into account for current earnings and profits purposes in a taxable year other than the year in which it is taken into account in computing pre-adjustment AMTI.

An analogous rule applies for deduction items. Section 1.56(g)-1(d)(1) provides that, in general, no deduction is allowed in computing ACE for amounts that are not deductible in any taxable year for purposes of computing current earnings and profits. Thus, ACE is increased by amounts that are deductible in determining pre-adjustment AMTI if these amounts are not also deductible in determining current earnings and profits. Only deduction items, however, that are permanently disallowed in determining current earnings and profits must be included in ACE under this rule.

III. *Treatment of ownership changes.*

A. *Definition of ownership change.*

For purposes of computing ACE, the adjusted bases of the assets of a corporation are restated after an "ownership change" in order to eliminate any net unrealized built-in loss in those assets. Whether an ownership change occurs is determined by reference to the provisions of section 382. The regulations under section 382 provide that an ownership change occurs upon certain owner shifts or equity structure shifts of a corporation that is a loss corporation. Through its cross-reference to §1.382-2T(f)(1), §1.56(g)-1(k)(2) defines "loss corporation" to include any corporation that, for regular tax purposes, has a loss carryforward, a net unrealized built-in loss, or excess credits under section 383.

Due to the slower cost recovery allowances used for ACE purposes, a corporation with a net unrealized built-in loss for ACE purposes (*i.e.*, determined by reference to the ACE adjusted basis of the corporation's assets) may not have a net unrealized built-in loss for regular tax purposes and therefore may not be a loss corporation for regular tax purposes. Under the proposed regulations, however, an ownership change is deemed to occur for ACE purposes only if

the corporation has an ownership change for regular tax purposes. Thus, a corporation that has a net unrealized built-in loss with respect to its assets for ACE purposes but is not a loss corporation for regular tax purposes will not be treated as having had an ownership change for ACE purposes.

The nature of ACE as a separate tax system suggests that the ACE basis of a corporation's assets should be used to determine whether it has a net unrealized built-in loss and is therefore a loss corporation. This approach would require a corporation to make ACE, as well as regular tax, determinations of its status as a loss corporation. Corporations then would have to track their stock ownership during ACE testing periods in addition to tracking it during regular tax testing periods. The Service concluded that this might impose an unwarranted burden upon taxpayers. Thus, in determining whether a corporation is a loss corporation, its net unrealized built-in loss is calculated using the basis of its assets for regular tax purposes. In the event of abuse, section 269 will apply to prevent tax-motivated attempts to avoid the application of the ACE ownership change provision by a corporation that has a net unrealized built-in loss for ACE purposes but not for regular tax purposes. If significant abuses develop, the Service will reconsider its decision not to use a corporation's adjusted basis for ACE purposes in determining whether a corporation is a loss corporation.

B. *Determination of net unrealized built-in loss.*

After a corporation is determined to have had an ownership change, the separate system concept generally applicable to ACE applies to the computation of the amount of a net unrealized built-in loss. Thus, under the proposed regulations, a corporation that undergoes an ownership change for regular tax purposes must eliminate any net unrealized built-in loss as determined by reference to the ACE adjusted basis of the corporation's assets. For example, a corporation that is a loss corporation for regular tax purposes (*e.g.*, due to net operating loss carryovers) but that does not have a net unrealized built-in loss determined by reference to the regular tax adjusted basis of its assets will nonetheless be required to eliminate net unrealized losses for ACE purposes if it has a net unrealized built-in loss determined by reference to the ACE adjusted basis of its assets.

IV. *Ordering rules for distributions by a FSC.*

In response to the intent of Congress, H. Rep. 99-841, 99th Cong., 2d Sess., II-275 (1986), the proposed regulations modify the ordering rules of §1.926(a)-1T(b)(1) for distributions by a Foreign Sales Corporation (FSC) received by a shareholder in a taxable year of the shareholder beginning after December 31, 1989. Distributions out of earnings and profits attributable to the FSC's non-exempt foreign trade income and other exempt foreign trade income determined under either of the administrative pricing methods of section 925(a)(1) or (2) (other than to the extent the distribution is allocable to the marketing of agricultural or horticultural products (or the providing of related services) by a qualified cooperative which is a shareholder of the FSC) will be made on a pro rata basis so that 15/23 (16/23 with regard to distributions to a non-corporate shareholder) of each distribution will be made out of earnings and profits attributable to exempt foreign trade income, and the remainder will be out of earnings and profits attributable to non-exempt foreign trade income.

V. *Effective dates for corporate partners in partnerships.*

Section 1.56(g)-1(p) provides special rules for determining the effective dates of the proposed regulations if a corporation is a partner in a partnership that has a taxable year other than that of the corporation. Under these rules, a corporate partner's distributive share of items of income and expense of a partnership are generally subject to the provisions of the proposed regulations for the partnership's taxable years ending within or with the taxable years of the corporate partner beginning after December 31, 1989. This provision is designed to prevent the omission of an item from the application of both the book income adjustment and the adjusted current earnings adjustment.

VI. *Specific Requests for Written Comments*

A. *Integration election.*

The Conference Report to the 1986 Act, H.R. Rep. No. 841, 99th Cong., 2nd Sess. II-278 (1986) [1986-3 C.B. (Vol. 4) 278], indicated a Congressional intent that the ACE and general minimum tax systems "be integrated regarding recordkeeping to the maximum extent feasible." The Service is currently studying the feasibility of integrating the ACE and general minimum tax recordkeeping requirements. Taxpayers are invited to recommend integration approaches that alleviate the recordkeeping burden without departing from the purposes of the ACE adjustment. In particular, the Service welcomes comments regarding the desirability of an election that would allow taxpayers to determine certain items for purposes of computing pre-adjustment AMTI in the same manner as these items are determined for purposes of computing ACE. For example, an election could allow taxpayers to use the ACE depreciation allowances for purposes of computing pre-adjustment AMTI. While making such an election would tend to increase the taxpayer's minimum tax liability, the need for a separate ACE depreciation and adjusted basis record would be eliminated.

B. *Simplification measures.*

The Service welcomes comments and suggestions on ways to reduce the complexity of the regulations, consistent with the legislative mandate of section 56(g). The Service especially encourages specific suggestions, such as safe harbors and *de minimis* rules, that both substantially further the intent of Congress and significantly reduce the administrative burden on taxpayers and the Service.

C. *Consolidated groups and foreign corporations.*

The proposed regulations provide general rules for the computation of ACE by an affiliated group of corporations joining in the filing of a consolidated federal income tax return (a consolidated group). Consolidated groups will compute their pre-adjustment AMTI and ACE on a consolidated, rather than a separate company, basis. The Service invites comments and suggestions on areas in which the consolidated return rules interact with ACE. These areas include (1) how to avoid a double inclusion in ACE through the interac-

tion of paragraph (c) of the proposed regulations with the consolidated return regulations, (2) whether limitations similar to the separate return limitation year rules of §1.1502-21(c) should apply in determining whether the positive ACE adjustments for separate return years may be considered in computing the limitation on negative adjustments under paragraph (n)(2) of the proposed regulations, and (3) how to determine the portion of a consolidated group's positive ACE adjustments that is allocated to a member leaving the group.

The proposed regulations reserve discussion of the application of ACE to foreign corporations. The Service invites comments and suggestions on this subject.

D. *Policy acquisition expenses of life insurance companies.*

Section 56(g)(4)(F) requires that, in determining ACE, policy acquisition expenses of life insurance companies must be capitalized and amortized in accordance with the treatment generally required under generally accepted accounting principles. The Service is currently studying methods of amortizing life insurance company policy acquisition expenses for ACE purposes. Taxpayers are invited to recommend simplified amortization approaches that would not reduce revenue. Comments are specifically invited on the following issues: (1) what expenses are properly deferred, (2) whether amortization schedules for ACE purposes should be based on gross premiums or net profits, including whether this computation should take into account investment income, (3) what factors should be considered in determining the appropriate deferral period, (4) the appropriate treatment of policy acquisition expenses when transactions are reported differently for tax and financial reporting purposes, and (5) whether reserve deductions should be taken into account in determining appropriate amortization schedules.

While the Service continues its analysis of these and other relevant issues, the rules provided in paragraph (h) for the capitalization and amortization of policy acquisition expenses of life insurance companies may be relied upon until further guidance is published.

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these proposed rules, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(b) of the Internal Revenue Code, these proposed rules will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adapted, consideration will be given to any written comments that are submitted (preferrably nine copies) to the Internal Revenue Service. All comments will be available of public inspection and copying. A public hearing is scheduled for Tuesday, October 16, 1990 (and Wednesday, October 17, 1990, if necessary). Notice of Public Hearing is published in *** [Announcement 90-75, 1990-22 I.R.B. 32].

List of subjects

26 CFR §§1.01-1—1.56(g)

Income taxes, Tax liability, Tax rates

26 CFR §§1.861-1 through 1.999-1

Aliens, DISC, Exports, Foreign investment in U.S., Foreign tax credit, Income taxes, Sources of income, United States investments abroad.

Proposed amendments to the regulations

Accordingly, 26 CFR Part 1 is proposed to be amended as follows:

Paragraph 1. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805 *** Section 1.56(g)-1 is also issued under section 7611(g)(3) of the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239, 103 Stat. 2373) [page 210, this Bulletin].

Paragraph 2. The following new section is added immediately following the appropriate place to read as follows:

§1.56(g)-0 Table of contents.

This section lists the paragraphs contained in §1.56(g)-1.

§1.56(g)-1 Adjusted current earnings.

(a) Adjustment for adjusted current earnings.

(1) Computation of adjustment.

(i) In general.

(ii) Negative amounts.

(2) Allowance of negative adjustment.

(i) In general.

(ii) Limitation on negative adjustment.

(iii) Example.

(3) Taxpayers subject to adjustment for adjusted current earnings.

(4) General rule for applying Internal Revenue Code provisions in determining adjusted current earnings.

(i) In general.

(ii) Example.

(5) Definitions.

(i) Pre-adjustment alternative minimum taxable income.

(ii) Adjusted current earnings.

(iii) Earnings and profits.

(b) Depreciation.

(1) Property placed in service after 1989.

(2) Property subject to new ACRS.

(i) In general.

(ii) Rules for computing the depreciation deduction.

(iii) Example.

(3) Special rule for certain section 168-(f) property.

(4) Property subject to original ACRS.

(i) In general.

(ii) Rules for computing the depreciation deduction.

(iii) Example.

(5) Certain property not subject to ACRS.

(c) Inclusion in adjusted current earnings of items included in earnings and profits.

(2) In general.

(2) Certain amounts not taken into account in determining whether an item is permanently excluded.

(3) Allowance of offsetting deductions.

(4) Special rule for income from the discharge of indebtedness.

(5) Treatment of life insurance contracts.

(i) In general.

(ii) Inclusion of inside build-up.

(iii) Calculation of income on the contract.

(iv) Treatment of distributions under the life insurance contract.

(v) Treatment of death benefits.

(vi) Other rules.

(A) Term life insurance contracts without net cash surrender values.

(B) Life insurance contraxts involving divided ownership.

(vii) Examples.

(6) Partial list of income items excluded from gross income but included in earnings and profits.

(d) Disallowance of items not deductible in computing earnings and profits.

(1) In general.

(2) Deductions for certain dividends received.

(i) Certain amounts deducted under sections 243 and 245.

(ii) Special rules.

(A) Dividends received from a foreign sales corporation.

(B) Dividends received from a section 936 corporation.

(iii) Special rule for certain dividends received by certain cooperatives.

(3) Partial list of items not deductible in computing earnings and profits.

(4) Partial list of deduction items treated the same for purposes of computing pre-adjustment alternative minimum taxable income and adjusted current earnings.

(e) Disallowance of deductions not allowable in computing pre-adjustment alternative minimum taxable income.

(f) Certain other earnings and profits adjustments.

(1) Intangible drilling costs.

(2) Certain amortization provisions not to apply.

(3) LIFO inventory adjustments.

(4) Installment sales.

(i) In general.

(ii) Exception for prior dispositons.

(iii) Special rule for obligations to which section 453A applies.

(A) In general.

(B) Limitation on application of installment method.

(C) Treatment of the ineligible portion.

(D) Treatment of the eligible portion.

(E) Coordination with the pledge rule.

(F) Example.

(g) Disallowance of loss on exchange of debt pools. [RESERVED]

(h) Policy acquisition expenses of life insurance companies.

(1) In general.

(2) Reasonably estimated life.

(3) Reasonable allowance for amortization.

(4) Safe harbor for public financial statements.

(5) Treatment of acquisition expenses when transactions are reported differently for tax and financial reporting purposes. [RESERVED]

(i) [RESERVED]

(j) Depletion.

(k) Treatment of certain ownership changes.

(1) In general.

(2) Definition of ownership change.

(3) Determination of net unrealized built-in loss immediately before an ownership change.

(4) Example.

(l) [RESERVED]

(m) Adjusted current earnings of foreign corporations. [RESERVED]

(n) Adjustment for adjusted current earnings of consolidated groups.

(1) In general.

(2) Allowance of negative adjustment.

(i) In general.

(ii) Limitation on negative adjustment.

(3) Definitions.

(i) Consolidated pre-adjustment alternative minimum taxable income.

(ii) Consolidated adjusted current earnings.

(4) Example.

(o) [RESERVED]

(p) Effective dates for corporate partners in partnerships.

(1) In general.

(2) Application of effective dates.

(3) Example.

Paragraph 3. The following new section is added immediately after §1.56(g)-0 to read as set forth below:

§1.56(g)-1 Adjusted Current Earnings.

(a) *Adjustment for adjusted current earnings*—(1) *Computation of adjustment*—(i) *In general.* For taxable years beginning after December 31, 1989, the alternative minimum taxable income of any taxpayer subject to the adjustment for adjusted current earnings (as specified in paragraph (a)(3) of this section) is increased by the adjustment for adjusted current earnings described in this section. The adjustment for adjusted current earnings is 75 percent of the excess, if any, of—

(A) The adjusted current earnings (as defined in paragraph (a)(5)(ii) of this section) of the taxpayer for the taxable year, over

(B) The pre-adjustment alternative minimum taxable income (as defined in paragraph (a)(5)(i) of this section) of the taxpayer for the taxable year.

(ii) *Negative amounts.* In determining whether an excess exists under paragraph (a)(1)(i) of this section, a positive amount exceeds a negative amount by the sum of the absolute numbers, and a smaller negative amount exceeds a larger negative amount by the difference between the absolute numbers. Thus, for example, a positive amount of adjusted current earnings of $30 exceeds a negative amount (or loss) of pre-adjustment AMTI of $10 by the sum of the absolute numbers, or $40 (30 + 10). Accordingly, the adjustment for adjusted current earnings would be 75 percent of $40, or $30. In contrast, a negative amount of adjusted current earnings of $10 exceeds a negative amount (or loss) of pre-adjustment alternative minimum taxable income of $30 by the difference between the absolute numbers, or $20 (30-10). Accordingly, the adjustment for adjusted current earnings would be 75 percent of $20, or $15.

(2) *Allowance of negative adjustment*—(i) *In general.* For taxable years beginning after December 31, 1989, the alternative minimum taxable income of any taxpayer is decreased, subject to the limitation of paragraph (a)(2)(ii) of this section, by 75 percent of the excess, if any, of

pre-adjustment alternative minimum taxable income, as defined in paragraph (a)(5)(i) of this section, over adjusted current earnings, as defined in paragraph (a)(5)(ii) of this section.

(ii) *Limitation on negative adjustment.* The amount of the negative adjustment for any taxable year is limited to the excess, if any, of—

(A) The aggregate increases in alternative minimum taxable income in prior years under paragraph (a)(1) of this section, over

(B) The aggregate decreases in alternative minimum taxable income in prior years under this paragraph (a)(2).

Any excess of pre-adjustment alternative minimum taxable income over adjusted current earnings that is not allowed as a negative adjustment in any taxable year because of the limitations of this paragraph (a)(2)(ii) is not applied to reduce any positive adjustment in any other taxable year.

(iii) *Example.* The following example illustrates the provisions of this paragraph (a)(2):

(A) Corporation P is a calendar-year taxpayer and has pre-adjustment alternative minimum taxable income and adjusted current earnings in the following amounts for 1990 through 1993:

Year	*Pre-adjustment alternative minimum taxable income*	*Adjusted current earnings*
1990	$800,000	$700,000
1991	600,000	900,000
1992	500,000	400,000
1993	500,000	100,000

(B) Under these facts, corporation P has the following positive and negative adjustments for adjusted current earnings:

Year	*Negative* adjustment	*Positive* adjustment
1990	-0-	-0-
1991	-0-	$ 225,000
1992	$ 75,000	-0-
1993	150,000	-0-

(C) In 1990, P has a potential negative adjustment (before the cumulative limitation) of $75,000 (75 percent of the $100,000 excess of pre-adjustment alternative minimum taxable income over adjusted current earnings). Nonetheless, P is not permitted a negative adjustment because P had no prior increases in its alternative minimum taxable income due to an adjustment for adjusted current earnings.

(D) In 1991, P has a positive adjustment of $225,000 (75 percent of the $300,000 excess of adjusted current earnings over pre-adjustment alternative minimum taxable income). P is not allowed to use the prior year's excess of pre-adjustment alternative minimum taxable income over adjusted current earnings to reduce its 1991 positive adjustment.

(E) In 1992, P is permitted a negative adjustment of $75,000, the full amount of 75 percent of the $100,000 excess of pre-adjustment alternative minimum taxable income over adjusted current earnings for the taxable year. This is because P's prior cumulative increases in alternative minimum taxable income due to the positive adjustments for adjusted current earnings exceed the negative adjustment for the year.

(F) In 1993, P has a potential negative adjustment (before the cumulative limitation) of $300,000 (75 percent of the $400,000 excess of pre-adjustment alternative minimum taxable income over adjusted current earnings). P's net cumulative increases in alternative minimum taxable income due to the adjustment for adjusted current earnings are $150,000 ($225,000 increase in 1991, less $75,000 decrease in 1992). Thus, P's negative adjustment in 1993 is limited to $150,000. P may not use the remaining portion ($150,000) of the negative adjustment for 1993 to reduce positive adjustments in other taxable years.

(3) *Taxpayers subject to adjustment for adjusted current earnings.* The adjustment for adjusted current earnings applies to any corporation other than—

(i) An S corporation as defined in section 1361,

(ii) A regulated investment company as defined in section 851,

(iii) A real estate investment trust as defined in section 856, or

(iv) A real estate mortgage investment conduit as defined in section 860A.

(4) *General rule for applying Internal Revenue Code provisions in determining adjusted current earnings*—(i) *In general.* Except as otherwise provided by regulations or other guidance issued by the Internal Revenue Service, all Internal Revenue Code provisions that apply in determining the regular taxable income of a taxpayer also apply in determining adjusted current earnings. For example, the rules of part V of subchapter P (relating to original issue discount and similar matters) of the Code apply in determining the amount (and the timing) of any interest income included in adjusted current earnings under this section. In applying Code provisions, however, the adjustments of this section and section 56(g) are also taken into account. For example, in applying the capitalization provisions of section 263A, the amount of depreciation to be capitalized is based on the amount of depreciation allowed in computing adjusted current earnings.

(ii) *Example.* The following example illustrates the provisions of this paragraph (a)(4):

(A) Corporation N is a calendar year manufacturer of golf clubs. N places new manufacturing equipment in service in 1990. The regular tax depreciation allowable for this equipment is $80,000; the pre-adjustment alternative minimum taxable income depreciation is $60,000; and the adjusted current earnings depreciation is $40,000. All of the golf clubs N produces in 1990 are unsold and are in ending inventory.

(B) Pursuant to section 263A and §1.263A-1T(b)(2)(iii) (J), N must capitalize the depreciation allowed for the year for the new manufacturing equipment in the ending inventory of golf clubs. Thus, when N sells the golf clubs (or is deemed to have sold them under its normal method of accounting), the cost of goods sold attributable to the capitalized depreciation will be $80,000 in computing regular taxable income; $60,000 in computing pre-adjustment alternative minimum taxable income; and $40,000 in computing adjusted current earnings.

(5) *Definitions.* The following terms have the following meanings for purposes of this section.

(i) *Pre-adjustment alternative minimum taxable income.* Pre-adjustment alternative minimum taxable income is the alternative minimum taxable income of the taxpayer for the taxable year, determined under section 55(b)(2), but without the adjustment for adjusted current earnings and without the alternative tax net operating loss deduction under section 56(a)(4).

(ii) *Adjusted current earnings.* Adjusted current earnings is the pre-adjustment alternative minimum taxable income of the taxpayer for the taxable year, adjusted as provided in this section and in section 56(g).

(iii) *Earnings and profits.* Earnings and profits means current earnings and profits within the meaning of section 316(a)(2), that is, earnings and profits of the taxable year computed as of the close of the taxable year of the corporation without diminution by reason of any distributions made during the taxable year.

(b) *Depreciation.* The depreciation deduction for computing adjusted current earnings is determined under the rules of this paragraph (b). Generally, the rules for computing the depreciation deduction differ depending on the taxable year in which the property is placed in service and the method used in computing the depreciation deduction for taxable income purposes.

(1) *Property placed in service after 1989.* The depreciation deduction for property placed in service in a taxable year beginning after December 31, 1989, is the amount determined by using the alternative depreciation system of section 168(g). This paragraph (b)(1) does not apply to property to which paragraph (b)(3) of this section applies (relating to certain property described in section 168(f)).

(2) *Property subject to new ACRS*—(i) *In general.* This paragraph (b)(2) provides the rules for computing the depreciation deduction for property to which the amendments made by section 201 of the Tax Reform Act of 1986 (new ACRS) apply (generally property placed in service after December 31, 1986), and that is placed in service in a taxable year beginning before January 1, 1990. This paragraph (b)(2) does not apply to property described in paragraph (b)(3) of this section (relating to certain property described in section 168(f)) or to property excluded from the application of new ACRS by section 168(f)(5)(i) (relating to certain churning transactions). See paragraph (b)(5) of this section for the rule that applies to certain property not subject to ACRS.

(ii) *Rules for computing the depreciation deduction.* The depreciation deduction for property described in this paragraph (b)(2) is the amount determined by using—

(A) the adjusted basis of the property as determined in computing alternative minimum taxable income as of the close of the last taxable year beginning before January 1, 1990,

(B) the straight-line method, and

(C) the recovery period that consists of the remainder of the recovery period applicable to the property under the alternative depreciation system of section 168(g). Thus, the recovery period begins on the first day of the first taxable year beginning after December 31, 1989, and ends on the last day of the recovery period that would have applied had the recovery period for the property originally been determined under section 168(g)(2). In determining the recovery period that would have applied, the property is deemed placed in service on the date it was considered placed in service under the depreciation convention that would have applied to the property under section 168(d).

(iii) *Example.* The following example illustrates the provisions of this paragraph (b)(2).

Example. Corporation X, a calendar-year taxpayer, purchases and places in service on August 1, 1987, computer-based telephone central office switching equipment. This is the only item of depreciable property X places in service during 1987. Thus, the applicable convention under section 168(d) is the half-year convention. As of December 31, 1989, the adjusted basis of the property used in computing alternative minimum taxable income is $42,000. The recovery period that would have applied to the property under section 168(g)(2) is 9.5 years (from July 1, 1987 to December 31, 1996). Thus, the recovery period for computing adjusted current earnings under section 56(g)(4)(A)(ii) and this paragraph (b)(2) begins on January 1, 1990, and ends on December 31, 1996. X's 1990 depreciation deduction for computing adjusted current earnings is $6,000, determined under the straight-line method by dividing $42,000 (adjusted basis) by 7 (recovery period).

(3) Special rule for certain section 168(f) property. The depreciation or amortization deduction for property excluded from new ACRS because the property is described in paragraphs (1), (2), (3), or (4) of section 168(f) is determined in the same manner as used in computing taxable income.

(4) *Property subject to original ACRS*—(i) *In general.* This paragraph (b)(4) provides the rules for computing the depreciation deduction for property to which section 168 as in effect on the day before the date of enactment of the Tax Reform Act of 1986 (original ACRS) applies (generally property to which new ACRS does not apply and that was placed in service after December 31, 1980), and that is placed in service in a taxable year beginning before January 1, 1990. In determining whether original ACRS applies to property, the fact that the unadjusted basis of the property is reduced or eliminated under section 168(d)(4)(A)(i) of original ACRS is not taken into account.

(ii) *Rules for computing the depreciation deduction.* The depreciation deduction for property described in this paragraph (b)(4) is the amount determined by using—

(A) the adjusted basis of the property as determined in computing taxable income as of the close of the last taxable year beginning before January 1, 1990,

(B) the straight-line method, and

(C) the recovery period that consists of the remainder of the recovery period applicable to the property under the alternative depreciation system of section 168(g). Thus, the recovery period begins on the first day of the first taxable year beginning after December 31, 1989, and ends on the last day of the recovery period that would have applied had the recovery period for the property originally been determined under section 168(g)(2). In determining the recovery period that would have applied, the property is deemed placed in service on the date it was considered placed in service under the depreciation convention that would have applied to the property under section 168(d) (without regard to section 168(d)(3)).

(iii) *Example.* The following example illustrates the provisions of this paragraph (b)(4).

Example. Corporation Y, a calendar-year taxpayer, purchases and places in service on December 1, 1986, computer-based telephone central office switching equipment. The depreciation convention that would have applied to this property under section 168(d) (without regard to section 168(d)(3)) is the half-year convention. As of December 31, 1989, the adjusted basis of the property used in computing taxable income is $21,000. The recovery period for the property under section 168(g)(2) is 9.5 years (from July 1, 1986 to December 31, 1995). Thus, the recovery period for computing adjusted current earnings under section 56(g)(4)(A)(iii) and this paragraph (b)(4) begins on January 1, 1990, and ends on December 31, 1995. X's 1990 depreciation deduction for computing adjusted current earnings is $3,500, determined under the straight-line method by dividing $21,000 (adjusted basis) by 6 (recovery period).

(5) *Certain property not subject to ACRS.* The depreciation or amortization deduction for property not described in paragraphs (b)(1), (b)(2), (b)(3), or (b)(4) of this section is determined in the same manner as used in computing taxable income. Thus, this paragraph (b)(5) applies to—

(i) Property placed in service after December 31, 1980, in a taxable year beginning before January 1, 1990, and that is excluded from the application of original ACRS or new ACRS by section 168(e)(4) of original ACRS or section 168(f)(5)(A)(i) of new ACRS, and

(ii) Property placed in service before January 1, 1981.

(c) *Inclusion in adjusted current earnings of items included in earnings and profits*—(1) *In general.* Except as

otherwise provided in paragraph (c)(4) of this section, adjusted current earnings includes all income items that are permanently excluded from (*i.e.*, not taken into account in determining) pre-adjustment alternative minimum taxable income but that are taken into account in determining earnings and profits. An income item is considered taken into account in determining pre-adjustment alternative minimum taxable income without regard to the timing of its inclusion. Thus, this paragraph (c)(1) does not apply to any income item that is, has been, or will be included in pre-adjustment alternative minimum taxable income. For example, a taxpayer eligible to use the completed contract method of accounting for long-term construction contracts does not take income (or expenses) into account in determining pre-adjustment alternative minimum taxable income for taxable years before the taxable year the contract is completed. Rather, the taxpayer is required under section 312(n)(6) to include income (and expenses) in earnings and profits throughout the term of the contract under the percentage of completion method. This paragraph (c)(1) does not require the income on the contract to be included in adjusted current earnings, however, because the income will be taken into account in the taxable year the contract is completed and therefore is considered to be taken into account in determining pre-adjustment alternative minimum taxable income.

(2) *Certain amounts not taken into account in determining whether an item is permanently excluded.* The fact that proceeds from an income item may eventually be reflected in pre-adjustment alternative minimum taxable income of another taxpayer on the liquidation or disposal of a business, or similar circumstances, is not taken into account in determining whether the item is permanently excluded from pre-adjustment alternative minimum taxable income. Thus, for example, a corporation's adjusted current earnings include interest excluded from pre-adjustment alternative minimum taxable income under section 103 even though the interest might eventually be reflected in the pre-adjustment alternative minimum taxable income of a corporate shareholder as gain on the liquidation of the corporation.

(3) *Allowance of offsetting deductions.* In determining adjusted current earnings under this paragraph (c), a deduction is allowed for all items that relate to income required to be included in adjusted current earnings under this paragraph (c) and that would be deductible in computing pre-adjustment alternative minimum taxable income if the income items to which the items of deduction relate were included in pre-adjustment alternative minimum taxable income for any taxable year. For example, deductions disallowed under section 265(a)(2) for the costs of carrying tax-exempt obligations, the interest on which is excluded from pre-adjustment alternative minimum taxable income under section 103 but is included in adjusted current earnings under this paragraph (c), are generally allowed as deductions in computing adjusted current earnings. Amounts deductible under this paragraph (c)(3) are taken into account using the taxpayer's method of accounting and are subject to any provisions or limitations of the Code that would have applied if the amounts had been deductible in determining pre-adjustment alternative minimum taxable income. For example, section 267(a)(2) may affect the timing of a deduction otherwise disallowed under section 265(a)(2).

(4) *Special rule for income from the discharge of indebtedness.* Amounts excluded from gross income under section 108 of the Internal Revenue Code of 1986 or any corresponding provision of law repealed by the Bankruptcy Tax Act of 1980 are not included in adjusted current earnings.

(5) *Treatment of life insurance contracts*—(i) *In general.* This paragraph (c)(5) addresses the treatment of life insurance contracts in determining adjusted current earnings. These rules apply to life insurance contracts as defined in section 7702. Generally, death benefits under a life insurance contract are included in adjusted current earnings, and all other distributions (including surrenders) are taxed in accordance with the principles of section 72(e), taking into account the taxpayer's basis in the contract for purposes of adjusted current earnings. In addition, undistributed income on the contract is included in adjusted current earnings as provided in paragraph (c)(5)(ii) of this section. Paragraph (c)(5)(vi)(A) of this section provides special rules for term insurance that has no net surrender value.

(ii) *Inclusion of inside buildup.* Income on a life insurance contract with respect to a taxable year (or any shorter period either ending or beginning with the date of a distribution from the contract) is included in adjusted current earnings for the taxable year. Thus, income on the contract is calculated from the beginning of a taxable year to the date of any distribution, from immediately after any distribution to the date of the next distribution, and from the last distribution during the taxable year through the end of the taxable year. Income on a life insurance contract is not included in adjusted current earnings for any taxable year in which the insured dies or the contract is completely surrendered for its entire net surrender value. Solely for purposes of computing adjusted current earnings, the taxpayer's adjusted basis in the contract (as determined under section 72(e)(6)) is increased to reflect any positive income on the contract included in adjusted current earnings under this paragraph (c)(5)(ii). The manner in which the income on the contract is determined for adjusted current earnings purposes is prescribed in paragraph (c)(5)(iii) of this section. If the income on the contract determined under paragraph (c)(5)(iii) of this section is a negative amount, income on the contract is not included in adjusted current earnings and no deduction from adjusted current earnings is allowed for the negative amount.

(iii) *Calculation of income on the contract.* For purposes of determining adjusted current earnings, the income on a life insurance contract for any period, including a taxable year, is the excess, if any, of—

(A) The sum of the contract's net surrender value (as defined in section 7702(f)(2)(B)) at the end of the period, and any distributions under the contract during the period that, in accordance with the principles of section 72(e), are not taxed because they represent recoveries of the taxpayer's basis in the contract for adjusted current earnings, over

(B) The sum of the contract's net surrender value at the end of the preceding period, and any premiums paid under the contract during the period.

(iv) *Treatment of distributions under the life insurance contract.* Any distribution under a life insurance contract (whether a partial withdrawal or an amount received on complete surrender of the contract) is included in adjusted current earnings in accordance with the principles of section 72(e), taking into account the taxpayer's basis in the contract for purposes of computing adjusted current earnings. The taxpayer's basis in the contract is equal to the basis at the end of the immediately preceding period, plus any premiums paid before the distribution. The taxpayer's basis in the contract for purposes of adjusted current earnings is reduced, in accordance with the principles of section 72(e), to the extent that the distribution is not included in adjusted current earnings because it represents a recovery of that basis.

(v) *Treatment of death benefits.* The excess of the contractual death benefit of a life insurance contract over the taxpayer's adjusted basis in the contract for purposes of computing adjusted current earnings at the time of the insured's death is included in adjusted current earnings as provided by paragraph (c)(6)(i) of this section. The amount of the death benefit that is taken into account for adjusted current earnings includes the amount of any outstanding policy loan treated as forgiven or discharged by the insurance company upon the death of the insured.

(vi) *Other rules*—(A) *Term life insurance contracts without net surrender values.* Except as provided in this paragraph (c)(5)(vi), the requirements of paragraph (c)(5) of this section do not apply to term life insurance contracts that provide no net surrender value. Adjusted current earnings are reduced by any premiums paid under such a contract that are allocable to the insurance coverage provided during the taxable year. Any premiums paid that are not allocable to this coverage must be included in the basis of the contract. The death benefit under such a term insurance contract is included in adjusted current earnings as provided by paragraph (c)(5)(v) of this section.

(B) *Life insurance contracts involving divided ownership.* If the ownership of a life insurance contract is divided between different persons (for example, a split-dollar arrangement), the requirements of paragraph (c)(5) of this section apply to the separate ownership interests as though each interest were a separate contract.

(vii) *Examples.* The following examples illustrate the provisions of this paragraph (c)(5).

Example 1. (i) On January 1, 1987, corporation X, a calendar-year taxpayer, purchased a flexible premium life insurance contract with a death benefit of $100,000 and planned annual gross premiums of $2,200 payable on January 1 of each year. The net surrender value of the contract at the end of 1987 and subsequent years, together with the cumulative premiums for the contract at the end of each year, are set forth in the following table:

Year	*Cumulative Premiums Paid*	*Year-End Net Surrender Value*
1987	$ 2,200	$ 2,420
1988	4,400	5,082
1989	6,600	8,010
1990	8,800	11,231
1991	11,000	14,774

(ii) Under paragraph (c)(5)(ii) of this section, X must include $1,021 in adjusted current earnings for 1990. The inclusion is computed by subtracting from the net surrender value of the contract at the end of the taxable year ($11,231) the sum of the net surrender value of the contract at the end of the preceding taxable year ($8,010) plus the premiums paid during the taxable year ($2,200). See paragraph (c)(5)(iii) of this section. For purposes of determining adjusted current earnings, X's adjusted basis in the contract would be increased at the end of 1990 from $8,800 to $9,821 to reflect the $1,021 inclusion. See paragraph (c)(5)(ii) of this section. The income under the contract attributable to taxable years prior to 1990 does not increase X's adjusted basis in the contract.

(iii) For 1991, the income on the contract included in adjusted current earnings is determined in the same manner as the preceding year, and there is a corresponding increase in X's adjusted basis in the contract. Thus, for 1991, the income on the contract is $1,343, which is determined by subtracting from the net surrender value of the contract at the end of the taxable year ($14,774) the sum of the net surrender value at the end of the preceding taxable year ($11,231) plus the premiums paid during the taxable year ($2,200). At the end of 1991, X's adjusted basis in the contract for adjusted current earnings is $13,364, which reflects the basis of the contract at the beginning of 1991, increased by the premium paid during the year ($2,200) and the income on the contract that has been included in adjusted current earnings for the taxable year ($1,343).

Example 2. The facts are the same as in example (1), except that, after the payment of the premium for 1991, the insured dies and X receives the $100,000 death benefit under the contract. Under paragraph (c)(5)(ii) of this section, no amount is included in adjusted current earnings for income on the contract for the taxable year in which the insured dies. Instead, under paragraph (c)(5)(v) of this section, X must include in adjusted current earnings for 1991 the excess of the death benefit ($100,000) over the adjusted basis in the contract for purposes of computing adjusted current earnings at the time of the insured's death ($12,021), which equals X's adjusted basis in the contract at the end of 1990 ($9,821), increased by X's premium payment for 1991 ($2,200).

Example 3. (i) The facts are the same as in example (1), except that in addition to making the $2,200 planned premium payment for 1992, X receives a $16,200 distribution under the contract on February 1, 1992, leaving a net surrender value of $897 immediately following the distribution. On March 1, 1992, X pays an additional premium of $5,000 under the contract. The net surrender value of the contract at the end of 1992 is $6,396.

(ii) Treatment of the distribution. Under paragraph (c)(5)(iv) of this section, the $16,200 distribution in 1992 is included in adjusted current earnings as an amount taxable in accordance with the principles of section 72(e) to the extent that the distribution ($16,200) exceeds X's adjusted basis for adjusted current earnings, as determined at the end of the immediately preceding period, and including premiums paid through the period ending on the date of the distribution ($15,564). Thus, X must include $636 in adjusted current earnings for 1992 as an amount taxable in accordance with the principles of section 72(e).

(iii) Determination of the income on the contract. Under paragraph (c)(5)(iii) of this section, for 1992, the income on the contract must be separately determined for the period beginning with the first day of the taxable year to the date of the distribution and for the period beginning immediately after the distribution to the end of the taxable year, using the contract's net surrender values at the beginning and end of each of these periods. The income on the contract for the period beginning on January 1, 1992, and ending on February 1, 1992 (the date of the distribution) is equal to the excess, if any, of (A) the sum of the net surrender value at the end of the period ($897) and the amount of the distribution that is allocable to X's basis in the contract for adjusted current earnings ($15,564), over (B) the sum of the net surrender value at the end of the preceding taxable year ($14,774) plus any premiums paid on the contract during the period ($2,200). Because the net result of this computation is a negative amount (($897 + $15,564) − ($14,774 + $2,200) = −$513), no income on the contract for the period ending with the date of the distribution is included in adjusted current earnings for 1992.

(iv) Under paragraph (c)(5)(ii), X must also determine the income on the contract for the period beginning immediately after the distribution through the end of the taxable year. The income on the contract for this period is $499, which is equal to the excess of the net surrender value at the end of the taxable year ($6,396) over the sum of the net surrender value at the end of the preceding period ($897), plus any premiums paid during the period ($5,000). At the end of 1992, X's adjusted basis in the contract for adjusted current earnings is $5,499, determined by adding the income on the contract ($499) and the premiums

paid during the period ($5,000) to the basis at the end of the preceding period ($0).

(v) Thus, X must include a total of $1,135 ($636 + 499) in adjusted current earnings for 1992. This inclusion reflects both the undistributed income on the contract for the taxable year plus the amount of income from distributions under the contract that is taxed in accordance with the principles of section 72(e) using X's adjusted basis in the contract for adjusted current earnings.

(6) *Partial list of income items excluded from gross income but included in earnings and profits.* The following is a partial list of items that are permanently excluded from pre-adjustment alternative minimum taxable income but that are included in earnings and profits, and are therefore included in adjusted current earnings under this paragraph (c).

(i) Proceeds of life insurance contracts excluded under section 101, to the extent provided in paragraph (c)(5)(v) or (c)(5)(vi) of this section.

(ii) Interest excluded under section 103.

(iii) Amounts received as compensation for injuries or sickness excluded under section 104.

(iv) Income taxes of a lessor of property paid by a lessee excluded under section 110.

(v) Income attributable to the recovery of an item deducted in computing earnings and profits in a prior year that is excluded under section 111.

(vi) Amounts received as proceeds from sports programs excluded under section 114.

(vii) Cost-sharing payments excluded under section 126, to the extent section 126(e) does not apply.

(viii) Interest on loans used to acquire employer securities excluded under section 133.

(ix) Financial assistance excluded under section 597.

(d) *Disallowance of items not deductible in computing earnings and profits*—(1) *In general.* Except as otherwise provided in this paragraph (d), no deduction is allowed in computing adjusted current earnings for items not taken into account in determining earnings and profits for any taxable year even if the items are taken into account in determining pre-adjustment alternative minimum taxable income. These items therefore increase adjusted current earnings to the extent they are deductible in computing pre-adjustment alternative minimum taxable income. An item of deduction is considered taken into account without regard to the timing of its deductibility in computing earnings and profits. Thus, to the extent an item is, has been, or will be deducted for purposes of determining earnings and profits, it does not increase adjusted current earnings in the taxable year in which it is deducted for purposes of determining pre-adjustment alternative minimum taxable income. For example, a deduction allowed (in determining pre-adjustment alternative minimum taxable income) under section 196 for unused research credits allowable under section 41 is taken into account in computing earnings and profits because the costs that gave rise to the credit were deductible in computing earnings and profits when incurred. Therefore, the deduction does not increase adjusted current earnings. As a further example, payments by a United States parent corporation with respect to employees of certain foreign subsidiaries, which are deductible under section 176, are considered contributions to the capital of the foreign subsidiary for purposes of computing earnings and profits. Although the payments are not deductible in computing the earnings and profits of the United States parent corporation in the year incurred, the payments do increase the parent's basis in its stock in the foreign subsidiary. This basis increase will reduce any gain the parent may later realize for purposes of computing earnings and profits on the disposition on the stock of the foreign subsidiary. Therefore, the amount of the payment by the parent is considered taken into account in computing the earnings and profits of the parent and does not increase adjusted current earnings. Thus, only deduction items that are never taken into account in computing earnings and profits are disallowed in computing adjusted current earnings under this paragraph (d).

(2) *Deductions for certain dividends received*—(i) *Certain amounts deducted under sections 243 and 245.* Paragraph (d)(1) of this section does not apply to, and adjusted current earnings therefore are not increased by, amounts deducted under sections 243 and 245 that qualify as 100-percent deductible dividends under sections 243(a), 245(b) or 245(c), or to any dividend received from a 20-percent owned corporation (as defined in section 243(c)(2)), to the extent the dividend giving rise to the deductions is attributable to earnings of the paying corporation that are subject to federal income tax. Earnings are considered subject to federal income tax if the earnings are included on the federal income tax return (that is filed or, if not, that should be filed) of an entity subject to United States taxation even if there is no resulting United States tax liability (*e.g.*, because of net operating losses or tax credits, other than the credit provided for in section 936).

(ii) *Special rules*—(A) *Dividends received from a foreign sales corporation.* The portion of a dividend received from a foreign sales corporation (a FSC) that is classified as a 100-percent deductible dividend attributable to earnings of the FSC that are subject to federal income tax is that portion of the dividend that is distributed out of earnings and profits of the FSC attributable to nonexempt foreign trade income determined under either of the administrative pricing methods of section 925(a)(1) or (2). A FSC is defined in section 922 and, for purposes of this paragraph, includes a small FSC and a former FSC. The ordering rules for distributions from a FSC set forth in §1.926(a)-1T(b)(1) apply to determine the classification of earnings and profits out of which a distribution has been made.

(B) *Dividends received from a section 936 corporation.* In the case of a dividend received from a corporation eligible for the credit provided by section 936 (a section 936 corporation), only that part of the dividend distributed out of earnings and profits of the section 936 corporation attributable to income that is not eligible for the credit is attributable to earnings of the paying corporation that are subject to federal income tax. Dividends are deemed to be distributed first out of earnings and profits for the current taxable year of the section 936 corporation, to the extent thereof, and then out of the most recently accumulated earnings and profits, under the principles of section 316. With respect to a distribu-

tion of less than all of the earnings and profits for the current or any prior taxable year, the amount of the distribution attributable to income not eligible for the section 936 credit is determined on a pro rata basis. For example, assume that a section 936 corporation earns $100 of taxable income in its current taxable year, $10 of which is not eligible for the credit under section 936. If the section 936 corporation makes a distribution of $50 during that year, $5 of that distribution ($10 of income not eligible for the section 936 credit divided by $100 of taxable income, times $50 distributed) is deemed to be attributable to earnings of the paying corporation that are subject to federal income tax.

(iii) *Special rule for certain dividends received by certain cooperatives.* Paragraph (d)(1) of this section does not apply to, and adjusted current earnings do not include, any dividend received by any organization to which part I of subchapter T of the Code applies and that is engaged in the marketing of agricultural or horticultural products, if the dividend is paid by a FSC and is allowable as a deduction under section 245(c).

(3) *Partial list of items not deductible in computing earnings and profits.* The following is a partial list of items that are not taken into account in computing earnings and profits and thus are not deductible in computing adjusted current earnings.

(i) Unrecovered losses attributable to certain damages that are deductible under section 186, to the extent those damages were previously deducted in computing earnings and profits.

(ii) The deduction for small life insurance companies allowed under section 806.

(iii) Dividends deductible under the following sections of the Code:

(A) Dividends received by corporations that are deductible under section 243, to the extent paragraph (d) (2) (i) of this section does not apply.

(B) Dividends received on certain preferred stock that are deductible under section 244.

(C) Dividends received from certain foreign corporations that are deductible under section 245, to the extent neither paragraph (d)(2)(i) nor (d)(2)(iii) of this section applies.

(D) Dividends paid on certain preferred stock of public utilities that are deductible under section 247.

(E) Dividends paid to an employee stock ownership plan that are deductible under section 404(k).

(F) Non-patronage dividends that are paid and deductible under section 1382(c).

(4) *Partial list of deduction items treated the same for purposes of computing pre-adjustment alternative minimum taxable income and adjusted current earnings.* The following is a partial list of deduction items that are treated the same for purposes of computing pre-adjustment alternative minimum taxable income and adjusted current earnings. No adjustment to adjusted current earnings is required under this paragraph (d) for these items.

(i) Dividends paid on deposits by thrift institutions deductible under section 591.

(ii) Life insurance policyholder dividends deductible under section 808.

(iii) Patronage dividends of cooperatives deductible under section 1382(b).

(e) *Disallowance of deductions not allowable in computing pre-adjustment alternative minimum taxable income.* Except as specifically provided in paragraphs (c)(3) or (c)(5) of this section, no deduction is allowed for an item in computing adjusted current earnings if the item is not deductible in computing pre-adjustment alternative minimum taxable income for the taxable year. Thus, for example, capital losses in excess of capital gains for the taxable year are not deductible in computing adjusted current earnings for the taxable year.

(f) *Certain other earnings and profits adjustments*—(1) *Intangible drilling costs.* For purposes of computing adjusted current earnings, the amount allowable as a deduction for intangible drilling costs (as defined in section 263(c)) for amounts paid or incurred in taxable years beginning after December 31, 1989, is determined as provided in section 312(n)(2)(A).

(2) *Certain amortization provisions not to apply.* For purposes of computing adjusted current earnings, sections 173 (relating to circulation expenditures) and 248 (relating to organizational expenditures) do not apply to amounts paid or incurred in taxable years beginning after December 31, 1989.

(3) *LIFO inventory adjustments.* For purposes of computing adjusted current earnings, the adjustments provided for in section 312(n)(4) (relating to LIFO inventory) apply.

(4) *Installment sales*—(i) *In general.* Adjusted current earnings are computed without regard to the installment method, except as provided in this paragraph (f)(4).

(ii) *Exception for prior dispositions.* Paragraph (f)(4)(i) of this section does not apply to any disposition in a taxable year beginning before January 1, 1990, that is taken into account under the installment method for purposes of computing pre-adjustment alternative minimum taxable income. Thus, for any disposition in a taxable year beginning before January 1, 1990, the installment method applies in computing adjusted current earnings for taxable years beginning after December 31, 1989, to the same extent it applies in determining pre-adjustment alternative minimum taxable income for the taxable year.

(iii) *Special rule for obligations to which section 453A applies*—(A) *In general.* The following special rules apply to any installment sale occurring in a taxable year beginning after December 31, 1989, that results in an installment obligation to which section 453A(a)(1) applies and with respect to which pre-adjustment alternative minimum taxable income is determined under the installment method. As explained in paragraph (f)(4)(iii)(B) of this section, for purposes of computing adjusted current earnings, a portion of the contract price is eligible for the installment method, and the remainder of the contract price is not eligible for the installment method. Payments under the obligation are allocated pro-rata between the two accounting methods.

(B) *Limitation on application of installment method.* Only a portion of the contract price of an installment sale described in paragraph (f)(4)(iii)(A) of this section is eligible to be accounted for under the installment method for purposes of computing adjusted current earnings. The portion eligible for the installment method is equal to the total contract price of the sale multiplied by the

applicable percentage (as determined under section 453A(c)(4)) for the taxable year of the sale. The remainder of the contract price is not eligible to be accounted for under the installment method for purposes of computing adjusted current earnings. The gross profit ratio is determined without regard to this bifurcated treatment of the sale.

(C) *Treatment of the ineligible portion.* The gain on the sale that is taken into account in the taxable year of the sale for purposes of computing adjusted current earnings is equal to the gross profit ratio multiplied by the entire portion of the contract price that is ineligible for the installment method.

(D) *Treatment of the eligible portion.* For purposes of calculating adjusted current earnings, the amount of gain recognized in a taxable year on the portion of the contract price eligible for the installment method is equal to—

(*1*) the amount of payment received during the taxable year multiplied by the applicable percentage for the taxable year of the sale, multiplied by

(*2*) the gross profit ratio.

(E) *Coordination with the pledge rule.* For purposes of determining the amount treated as payment during the taxable year under paragraph (f)(4)(iii)(D), the rules of section 453A(d) (relating to the treatment of certain pledge proceeds as payments) apply. This includes the rules under section 453A(d)(3) that relate to treating later payments as receipts of amounts on which tax has already been paid.

(F) *Example.* The following example illustrates the provisions of this paragraph (f)(4)(iii):

(*1*) On January 1, 1990, corporation A, a calendar-year taxpayer, sells a building with an adjusted basis for purposes of computing adjusted current earnings of $10 million, for $5 million and an installment obligation bearing adequate stated interest with a principal amount of $20 million. The installment obligation calls for 4 annual payments of $5 million on January 1 of 1991, 1992, 1993 and 1994. A does not elect out of the installment method, and disposes of no other property under the installment method during 1990. No gain with respect to the sale is recaptured pursuant to section 1250.

(*2*) The gross profit percentage for purposes of computing adjusted current earnings on the sale is 60 percent, computed as follows: gross profit of $15 million ($25 million contract price less $10 million adjusted basis) divided by $25 million contract price. The applicable percentage on the sale is 75 percent, computed as follows: $15 million ($20 million of installment obligations arising during and outstanding at the end of 1990 less $5 million) divided by $20 million of installment obligations arising during and outstanding at the end of 1990. See section 453A(c)(4). The portion of the contract price eligible for accounting under the installment method for purposes of computing adjusted current earnings is $18.75 million, or $25 million total contract price times applicable percentage of 75 percent. The portion of the contract price ineligible for the installment method is $6.25 million, or $25 million less $18.75 million.

(*3*) In computing adjusted current earnings for 1990, A must include $3.75 million of the gain on the sale. This amount is equal to the portion of the contract price that is ineligible for the installment method times the gross profit ratio, or $6.25 million times 60 percent. A must also include $2.25 million of gain from the $5 million payment received in 1990. This amount is computed as follows: the eligible portion of the payment, $3.75 million ($5 million payment times the applicable percentage of 75 percent), times the gross profit ratio of 60 percent. Thus, the total amount of gain from the sale that A must include in adjusted current earnings for 1990 is $6 million ($3.75 million of gain from the portion of the contract price that is not eligible for the installment method, plus $2.25 million of gain from the 1990 payment).

(*4*) A does not pledge or otherwise accelerate payments on the note in any other taxable year. In computing adjusted current earnings for 1991, 1992, 1993 and 1994, A therefore includes $2.25 million of gain on the installment sale, computed as follows: $5 million payment times the applicable percentage of 75 percent, times the gross profit ratio of 60 percent.

(g) *Disallowance of loss on exchange of debt pools.* [RESERVED]

(h) *Policy acquisition expenses of life insurance companies*—(1) *In general.* This paragraph (h) addresses the treatment of policy acquisition expenses of life insurance companies in determining adjusted current earnings. Policy acquisition expenses are those expenses that, under generally accepted accounting principles in effect at the time the expenses are incurred, are considered to vary with and to be primarily related to the acquisition of new and renewal insurance policies. Generally, these acquisition expenses must be capitalized and amortized for adjusted current earnings purposes over the reasonably estimated life of the acquired policy, using a method that provides a reasonable allowance for amortization. This method of amortization is treated as if it applied to all taxable years in determining the amount of policy acquisition expenses deducted for adjusted current earnings. The rules in this paragraph (h) apply to any life insurance company, as defined in section 816(a).

(2) *Reasonably estimated life.* The reasonably estimated life of an acquired policy is determined based on the facts with respect to each policy (such as the age, sex and health of the insured), and the company's experience (such as mortality, lapse rate and renewals) with similar policies. A company may treat as the reasonably estimated life of an acquired policy the period for amortizing expenses of the acquired policy that would be required by the Financial Accounting Standards Board (FASB) at the time the acquisition expenses are incurred. If the FASB has not established such a period, the period for amortizing acquisition expense of an acquired policy under guidelines issued by the American Institute of Certified Public Accountants in effect at the time the acquisition expenses are incurred may be treated as the reasonably estimated life of the acquired policy.

(3) *Reasonable allowance for amortization.* For purpose of determining a reasonable allowance for amortization, a company may use a method that amortizes acquisition expenses in the same proportion that gross premiums and gross investment income for the taxable year bear to total anticipated receipts of gross premiums (including anticipated renewal premiums) and gross investment income to be realized over the reasonably estimated life of the policy.

(4) *Safe harbor for public financial statements.* Any company that is required to file with the Securities and Exchange Commission (SEC) a financial statement with respect to the taxable year will be treated as having complied with paragraph (h)(1) of this section if it accounts for acquisition expenses for adjusted current earnings purposes in the same manner as it accounts for those expenses on its financial statements filed with the SEC.

(5) *Treatment of acquisition expenses when transactions are reported differently for tax and financial reporting purposes.* [RESERVED]

(i) [RESERVED]

(j) *Depletion.* For purposes of computing adjusted current earnings, the allowance for depletion with respect

to any property placed in service in a taxable year beginning after December 31, 1989, is determined under the cost depletion method of section 611.

(k) *Treatment of certain ownership changes*—(1) *In general.* In the case of any corporation that has an ownership change as defined in paragraph (k)(2) of this section in a taxable year beginning after December 31, 1989, and that also has a net unrealized built-in loss (as defined in paragraph (k)(3) of this section) immediately before the ownership change, the adjusted basis of each asset of the corporation for purposes of computing adjusted current earnings following the ownership change shall be its proportionate share (determined on the basis of the respective fair market values of each asset) of the fair market value of the assets of the corporation immediately before the ownership change.

(2) *Definition of ownership change.* A corporation has an ownership change for purposes of this paragraph (k) if there is an ownership change under section 382(g) for purposes of computing the corporation's amount of taxable income that may be offset by pre-change losses or the regular tax liability that may be offset by pre-change credits. See §1.382-2T for rules to determine if a corporation has an ownership change. Accordingly, in order for an ownership change to occur for purposes of this paragraph (k), a corporation must be a loss corporation as defined in §1.382-2T(f)(1). In determining whether the corporation is a loss corporation, the determination of whether there is a net unrealized built-in loss is made by using the aggregate adjusted basis of the assets of the corporation used in computing taxable income. The aggregate adjusted basis of the corporation's assets for purposes of computing adjusted current earnings is not relevant in determining if the corporation is a loss corporation. See part (iv) of the example in paragraph (k)(4) of this section.

(3) *Determination of net unrealized built-in loss immediately before an ownership change.* To determine whether it has a net unrealized built-in loss for purposes of paragraph (k)(1) of this section, a corporation that has an ownership change as defined in paragraph (k)(2) of this section must use the aggregate adjusted basis of its assets that it uses in computing its adjusted current earnings. The rules of section 382 (including sections 382(h)(3)(B)(i) and 382(h)(8)) otherwise apply in determining whether the corporation has a net unrealized built-in loss.

(4) *Example.* The following example illustrates the provisions of this paragraph (k):

(i) Individual A has owned all the issued and outstanding stock of corporation L for the past 5 years. A sells all his stock in L to unrelated individual B. On the date of the sale, L owns the following assets (all numbers are in millions):

Asset	*Adjusted basis for computing taxable income*	*Adjusted basis for computing adjusted current earnings*	*Fair market value*
x	$ 45	$ 50	$ 50
y	55	60	30
z	10	10	20
	$ 110	$ 120	$ 100

For purposes of computing taxable income, L has a $500 million net operating loss carryforward to the taxable year in which the sale occurs. Therefore, L is a loss corporation. As a result of the transfer of shares of L from A to B, L has had an ownership change.

(ii) L has no net unrealized built-in loss for purposes of computing taxable income because the amount by which the aggregate adjusted basis of its assets for that purpose exceeds their fair market value is $10 million, which is less than 15 percent of their fair market value and is not greater than $10 million. See section 382(h)(3)(B)(i). L, however, does have a net unrealized built-in loss for purposes of computing adjusted current earnings because the aggregate adjusted basis of its assets for that purpose exceeds their fair market value by $20 million, and that amount is greater than $10 million.

(iii) Under paragraph (k)(1) of this section, L must restate the adjusted basis of its assets for purposes of computing adjusted current earnings to their fair market values, as follows (all numbers are in millions):

Asset	*New adjusted basis*
x	$ 50
y	30
z	20

L must use these new adjusted bases for all purposes in determining adjusted current earnings, including computing depreciation and any gain or loss on disposition.

(iv) If L did not have the net operating loss carryforward, and had no other loss or credit carryovers or other attributes described in §1.382-2T(f)(1) for purposes of computing the amount of its taxable income that may be offset by pre-change losses or its regular tax liability that may be offset by pre-change credits, it would not have been a loss corporation on the date of the sale and therefore would not be treated as having had an ownership change for purposes of computing adjusted current earnings. This would be true even though L had a net unrealized built-in loss for purposes of computing adjusted current earnings. Therefore, this paragraph (k) would not have applied.

(l) [RESERVED]

(m) *Adjusted current earnings of foreign corporations.* [RESERVED]

(n) *Adjustment for adjusted current earnings of consolidated groups*—(1) *In general.* The alternative minimum taxable income of a consolidated group (as defined in §1.1502-1T) is increased by the consolidated adjustment for adjusted current earnings. The consolidated adjustment for adjusted current earnings equals 75 percent of the excess, if any, of—

(i) the consolidated adjusted current earnings for the taxable year, over

(ii) the consolidated pre-adjustment alternative minimum taxable income for the taxable year.

(2) *Allowance of negative adjustment*—(i) *In general.* The alternative minimum taxable income of a consolidated group is decreased, subject to the limitation of paragraph (n)(2)(ii) of this section, by 75 percent of the excess, if any, of the consolidated pre-adjustment alternative minimum taxable income over consolidated adjusted current earnings.

(ii) *Limitation on negative adjustment.* The amount of the negative adjustment for any taxable year shall be limited to the excess, if any, of—

(A) the aggregate increases in the alternative minimum taxable income of the group in prior years under this section, over

(B) the aggregate decreases in the alternative minimum taxable income of the group in prior years under this section.

(3) *Definitions*—(i) *Consolidated pre-adjustment alternative minimum taxable income.* Consolidated pre-adjustment alternative minimum taxable income is the consolidated taxable income (as defined in §1.1502-11) of a consolidated group for the taxable year, determined with the adjustments provided in sections 56 and 58 (except for the adjustment for adjusted current earnings and the alternative tax net operating loss determined under section 56(a)(4)) and increased by the preference items described in section 57.

(ii) *Consolidated adjusted current earnings.* The consolidated adjusted current earnings of a consolidated group is the consolidated pre-adjustment alternative minimum taxable income of the consolidated group for the taxable year, adjusted as provided in this section and in section 56(g).

(4) *Example.* The following example illustrates the provisions of this paragraph (n):

(i) P is the common parent of a consolidated group. In 1990, the group has consolidated pre-adjustment alternative minimum taxable income of $1,400,000 and consolidated adjusted current earnings of $1,600,000. Thus, the group has a consolidated adjustment for adjusted current earnings for 1990 of $150,000 (75 percent of the $200,000 excess of consolidated adjusted current earnings over consolidated pre-adjustment alternative minimum taxable income), and alternative minimum taxable income of $1,550,000 ($1,400,000 plus $150,000).

(ii) In 1991, the group has consolidated pre-adjustment alternative minimum taxable income of $1,500,000 and consolidated adjusted current earnings of $1,100,000. Thus, the group can reduce its alternative minimum taxable income by $150,000. The potential negative adjustment of $300,000 (75 percent of the $400,000 excess of consolidated pre-adjustment alternative minimum taxable income over consolidated adjusted current earnings) is limited to the $150,000 consolidated adjustment for adjusted current earnings taken into account in 1990.

(o) [RESERVED]

(p) *Effective dates for corporate partners in partnerships*—(1) *In general.* The provisions of this section apply to a corporate partner's distributive share of items of income and expense from a partnership for any taxable year of the partnership ending within or with any taxable year of the corporate partner beginning after December 31, 1989.

(2) *Application of effective dates.* Solely for purposes of the effective date provisions of this section, a partnership event (such as placing property in service, paying or incurring a cost, or closing an installment sale) is deemed to occur on the last day of the partnership's taxable year.

(3) *Example.* The following example illustrates the provisions of this paragraph (p):

(i) X is a calendar-year corporation that is a partner in P, an accrual-basis partnership with a taxable year ending March 31. During P's taxable year ending March 31, 1990, P earned ratably throughout the year interest income on tax-exempt obligations. In addition, P incurred intangible drilling costs in November 1989 and in February 1990.

(ii) X's adjusted current earnings for 1990 includes X's distributive share of the interest on the tax-exempt obligations earned by P for its taxable year ending March 31, 1990. This is true even though P earned a portion of the interest prior to January 1, 1990.

(iii) For purposes of computing X's adjusted current earnings for 1990, the adjustment provided in paragraph (f)(1) of this section applies to X's distributive share of P's November 1989 and February 1990 intangible drilling costs.

Par. 4. The following center heading is added before §1.56A-1:

REGULATIONS APPLICABLE TO TAXABLE YEARS BEGINNING IN 1969 AND ENDING IN 1970

Par. 5. The following center heading is added before § 1.57:

TAX PREFERENCE REGULATIONS

Par. 6. Section 1.926(a)-1T(b)(1) is revised to read as follows:

§1.926(a)-1T Temporary Regulations; Distributions to shareholders.

* * * * *

(b) *Order of distribution*—(1) *In general*—(i) *Distributions by a FSC received by a shareholder in a taxable year of the shareholder beginning before January 1, 1990.* Any actual distribution to a shareholder by a FSC (all references to a FSC in this section shall include a small FSC and a former FSC) which is received by the shareholder in a taxable year of the shareholder beginning before January 1, 1990, and made out of earnings and profits shall be treated as made in the following order, to the extent thereof—

(A) Out of earnings and profits attributable to exempt foreign trade income determined solely because of operation of section 923(a)(4),

(B) Out of earnings and profits attributable to other exempt foreign trade income,

(C) Out of earnings and profits attributable to non-exempt foreign trade income determined under either of the administrative pricing methods of section 925(a)(1) or (2),

(D) Out of earnings and profits attributable to section 923(a)(2) non-exempt income, and

(E) Out of other earnings and profits.

(ii) *Distributions by a FSC received by a shareholder in a taxable year of the shareholder beginning after December 31, 1989.* Any actual distribution to a shareholder by a FSC (all references to a FSC in this section shall include a small FSC and a former FSC) which is made out of earnings and profits shall be treated as made in the following order, to the extent thereof

(A) Out of earnings and profits attributable to exempt foreign trade income determined solely because of the operation of section 923(a)(4),

(B) Out of earnings and profits attributable to foreign trade income (other than exempt foreign trade income determined solely because of the operation of section 923(a)(4)) allocable to the marketing of agricultural or horticultural products (or the providing of related services) by a qualified cooperative which is a shareholder of the FSC,

(C) Out of earnings and profits attributable to non-exempt foreign trade income and other exempt foreign trade income determined under either of the administrative pricing methods of section 925(a)(1) or (2). Distributions out of this classification will be made on a pro rata basis so that 15/23 (16/23 with regard to distributions to a non-corporate shareholder) of each distribution will be out of earnings and profits attributable to exempt foreign trade income and the remainder will be out of earnings and profits attributable to non-exempt foreign trade income.

(D) Out of earnings and profits attributable to other exempt foreign trade income determined under the transfer pricing method of section 925(a)(3),

(E) Out of earnings and profits attributable to section 923(a)(2) non-exempt income,

(F) Out of earnings and profits attributable to effectively connected income, as defined in section 245(c)(4)(B), and

(G) Out of other earnings and profits.

* * * * *

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on May 2, 1990, 8:45 a.m., and published in the issue of the Federal Register for May 3, 1990, 55 F.R. 18626)

Notice of Proposed Rulemaking

General Rule for Taxable Year of Inclusion—Election to Include Crop Insurance Proceeds in Gross Income in the Taxable Year Following the Taxable Year of Destruction or Damage

IA-012-90

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In *** [T.D. 8289, page 106, this Bulletin], the Internal Revenue Service is issuing temporary regulations clarifying the applicability of section 451(d) of the Internal Revenue Code (regarding the taxable year of inclusion for crop insurance proceeds) to certain federal payments made to farmers. The text of the temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: Proposed regulation §1.451-6T is proposed to be effective for payments received after December 31, 1973. Written comments and requests for a public hearing must be delivered by April 30, 1990.

ADDRESS: Send comments and requests for a public hearing to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Attn: CC: CORP:T:R (IA-012-90) Room 4429, Washington, D.C. 20044.

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed Income Tax Regulations (26 CFR Part 1) that provide rules relating to the applicability of section 451(d) of the Internal Revenue Code to certain federal payments. The preamble of the temporary regulations explains the concerns underlying the enactment of section 451(d) and the issuance of these proposed regulations.

Explanation of Provisions

Under the proposed regulations, federal payments received as a result of (a) destruction or damage to crops caused by drought, flood, or any other natural disaster or (b) the inability to plant crops because of such a natural disaster, shall be treated as insurance proceeds received as a result of destruction or damage to crops for purposes of section 451(d) of the Code.

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Request for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner of Internal Revenue by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on February 23, 1990, 4:28 p.m., and published in the issue of the Federal Register for March 1, 1990, 55 F.R. 7343)

Notice of Proposed Rulemaking

Certain Corporate Distributions to Foreign Corporations Under Section 367(e)

INTL-704-87

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In *** [T.D. 8280, page 80, this Bulletin], the Internal Revenue Service is issuing temporary Income Tax Regulations that add new sections necessary to implementing section 367(e)(1) and (2) of the Internal Revenue Code of 1986, relating to certain corporate distributions to foreign shareholders. These provisions affect the taxability of both corporate distributors and shareholder distributees. The regulations also add certain provisions under section 367(a) and (b) concerning reorganizations under section 368(a)(1)(F) involving foreign corporations. The text of the temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: Written comments and requests for a public hearing must be delivered or mailed before March 19, 1990.

Except as set forth below, these regulations are proposed to be effective with respect to distributions after July 31, 1986. The following provisions have the following special proposed effective dates:

§1.367(a)-1(e)	April 1, 1987
§1.367(a)-1(f)	January 1, 1985
§1.367(e)-1	February 16, 1990
§1.367(b)-1(e)	April 1, 1987
§1.367(n)-1(f)	January 1, 1985

ADDRESS: Send comments and requests for a public hearing to Commissioner of Internal Revenue, (Attention: CC:CORP:T:R INTL-704-87), Room 4429, Washington, DC 20224.

SUPPLEMENTARY INFORMATION:

PAPERWORK REDUCTION ACT

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1980 (44 U.S.C. §3504(h)). Comments on the collection of information should be sent to the Office of Management and Budget, Paperwork Reduction Project (1545-1124), Washington, D.C. 20503, with copies to the Internal Revenue Service, Attention: IRS

Reports Clearance Officer TR:FP, Washington, DC 20224.

The collection of information in this regulations is in section 1.367(e)-1T(c)(2) and section 1.367(e)-2T(b)(2)(i) and (c)(2)(i). This information is required by the Internal Revenue Service to ensure that gains recognized by the distributing and distributee corporations are reported on the appropriate income tax return. This information will be used to assure compliance with the provisions of the regulations. The likely respondents are business or other for-profit institutions.

These estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents/recordkeepers may require greater or less time, depending upon their particular circumstances.

Estimated total annual reporting and/or recordkeeping burden: 3,200 hours.

Estimated average annual burden per respondent: 8 hours.

Estimated number of respondents: 400.

Estimated annual frequency of responses: 1.

BACKGROUND

The temporary regulations published in *** [T.D. 8280, page 80, this Bulletin] add §§1.367(a)-1T(e) and (f), 1.367(e)-0T, 1.367(e)-1T, and 1.367(e)-2T to 26 CFR Part 1, and add new paragraphs (e) and (f) to §7.367(b)-1 of 26 CFR Part 7. The final regulations that are proposed to be based on these temporary regulations would amend 26 CFR Parts 1, 7 and 602 by adding these temporary regulations as final regulations under section 367(a), (b) and (e) of the Internal Revenue Code of 1986. For the text of the temporary regulations, see T.D. 8280 published in *** [page 80, this Bulletin].

SPECIAL ANALYSES

It has been determined that this proposed rule is not a major rule as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It is hereby certified that the proposed rule will not have a significant impact on a substantial number of small entities. Few small entities would be affected by these regulations. A regulatory flexibility analysis, therefore, is not required under the Regulatory Flexibility Act (5 U.S.C. chapter 6). Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably a signed original and eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the FEDERAL REGISTER.

LIST OF SUBJECTS IN 26 CFR §§1.301-1 TO 1.385-6

Income taxes, Corporations, Corporate Distributions, Corporate Adjustments and Reorganizations.

LIST OF SUBJECTS IN 26 CFR Part 7

Income taxes, Tax Reform Act of 1976.

LIST OF SUBJECTS IN 26 CFR PART 602

Reporting and recordkeeping requirements.

Proposal of regulations

The temporary regulations, FR Doc. T.D. 8280 published in *** [page 80, this Bulletin], are hereby also proposed as final regulations under section 367(a), (b) and (e) of the Internal Revenue Code of 1986.

Michael J. Murphy,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 12, 1990, 8:45 a.m., and published in the issue of the Federal Register on January 16, 1990, 55 F.R. 1472)

Notice of Proposed Rulemaking

Earnings and Profits of Controlled Foreign Corporations

INTL-40-89

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: This document contains proposed Income Tax Regulations relating to the election or adoption of tax accounting methods affecting the computation of earnings and profits of a controlled foreign corporation in post-1986 taxable years. Changes to the applicable law were made by the Tax Reform Act of 1986. These proposed regulations would provide guidance needed to comply with those statutory changes and would affect controlled foreign corporations and their United States shareholders. In *** [T.D. 8283, page 148, this Bulletin], the Internal Revenue Service is issuing temporary regulations relating to these matters. The text of those temporary regulations serves as the comment document for this proposed rulemaking.

DATES: These regulations are proposed to be effective for taxable years of a controlled foreign corporation beginning after December 31, 1986. Comments and requests for a public hearing must be delivered or mailed by March 26, 1990.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, (Attention: CC:CORP:T:R, INTL-40-89), Room 4429, Washington, D.C. 20224.

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulations published in *** [T.D. 8283, page 148, this Bulletin] add new §1.964-1T. The final regulations that are proposed to be based on the temporary regulations would amend 26 CFR Part 1. For the text of the temporary regulations, see T.D. 8283, published in *** [page 148, this Bulletin].

SPECIAL ANALYSES

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small businesses.

COMMENTS AND REQUEST FOR A PUBLIC HEARING

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably a signed original and eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request by any person who submits written comments on the proposed rules. Notice of the time and place for the hearing will be published in the FEDERAL REGISTER.

LIST OF SUBJECTS IN 26 CFR §§1.861-1 THROUGH 1.997-1

Income taxes, Corporate deductions, Aliens, Exports, DISC, Foreign investments in U.S., Foreign tax credit, FSC, Source of income, U.S. investments abroad.

Proposed amendments to the regulations

The temporary regulations published in *** [T.D. 8283, page 148, this Bulletin] are hereby also proposed as final regulations under section 964 of the Internal Revenue Code of 1986.

Fred T. Goldberg, Jr.,
Commissioner of the Internal Revenue.

(Filed by the Office of the Federal Register on January 24, 1990, 8:45 a.m., and published in the issue of the Federal Register for January 25, 1990, 55 F.R. 2535)

Notice of Proposed Rulemaking

Withholding of Tax on Nonresident Aliens

INTL-0660-89

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to a temporary regulation.

SUMMARY: This document contains a proposed Income Tax Regulation relating to withholding of tax on nonresident aliens. The proposed regulation would clarify that withholding under section 1441 is required with respect to a payment to a nonresident alien individual from any employees' trust described in section 401(a) of the Internal Revenue Code of 1986 (the "Code") that is exempt from tax under section 501(a) of the Code if an election of no withholding under section 3405(a)(2) or (b)(3) is in effect. In *** [T.D. 8288, page 163, this Bulletin], the Internal Revenue Service is issuing a temporary regulation relating to these matters. The text of that temporary regulation also serves as the comment document for this proposed rulemaking.

DATES: This regulation is proposed to be effective for payments made after February 26, 1990. Written comments and requests for a public hearing must be delivered or mailed by April 6, 1990.

ADDRESS: Send comments and requests for a public hearing to: Internal Revenue Service, (Attention: CC:CORP:T:R, (INTL-0660-89)), Room 4429, Washington, D.C. 20224.

SUPPLEMENTARY INFORMATION:

BACKGROUND

The temporary regulation published in *** [T.D. 8288, page 163, this Bulletin] adds §1.1441-4T to 26 CFR Part 1. The final regulation that is proposed to be based upon this temporary regulation would amend 26 CFR Part 1. For the text of the temporary regulation, see T.D. 8288 published in *** [page 163, this Bulletin].

SPECIAL ANALYSES

It has been determined that this proposed rule is not a major rule as defined in Executive Order 122291. Therefore, a Regulatory Impact Analysis is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulation, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation will be submitted to the Administrator of the Small Business Administration for comment on its impact on small business.

COMMENTS AND REQUEST FOR A PUBLIC HEARING

Before adopting these proposed regulation, consideration will be given to any written comments that are submitted (preferably a signed original and eight copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing will be held upon written request by any person who submits written comments on the proposed rule. Notice of the time and place for the hearing will be published in the FEDERAL REGISTER.

LIST OF SUBJECTS

26 CFR §§1.1441-1 to 1.1465-1

Income taxes, Aliens, Foreign corporations.

Proposed amendment to the regulations.

The temporary regulation, T.D. 8288, published in *** [page 163, this Bulletin], also is hereby proposed as a final regulation under section 1441 of the Internal Revenue Code of 1986.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on February 2, 1990, 8:45 a.m., and published in the issue of the Federal Register for February 5, 1990, 55 F.R. 3750)

Notice of Proposed Rulemaking

Leased Passenger Automobiles—Tables for Determining the Amount Included in Lessee's Income

PS-53-89

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In *** [T.D. 8298, page 64, this Bulletin], the Internal Revenue Service is issuing temporary regulations to provide for adjustments in the table used to determine the amounts included in income by lessees of passenger automobiles. The text of the temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: The regulations are proposed to apply to passenger automobiles that are first leased after December 31, 1986. Written comments and requests for a public hearing must be delivered by June 11, 1990.

ADDRESS: Send comments and requests for a public hearing to: Internal Revenue Service, Attn: CC:CORP:T:R (PS-53-89), P.O. Box 7604, Ben Franklin Station, Room 4429, Washington, D.C. 20044.

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations published in *** [T.D. 8298, page 64, this Bulletin] amend §1.280F-7T(a)(2) to provide for adjustments in the table used to determine the amounts included in income by lessees of passenger automobiles. This document proposes to adopt the temporary regulations as final regulations. For the text of the temporary regulations, see T.D. 8298, published in *** [page 64, this Bulletin]. The preamble to the temporary regulations explains the proposed and temporary rules.

Special Analyses:

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and, therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted, consideration will be given to any written comments that are submitted (preferably a signed original and eight copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Internal Revenue Service by any person who also submits written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on April 11, 1990, 8:45 a.m., and published in the issue of the Federal Register for April 12, 1990, 55 F.R. 13808)

Notice of Proposed Rulemaking

Limitations on Passive Activity Losses and Credits—Miscellaneous

PS-065-89

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In *** [T.D. 8290, page 109, this Bulletin] the Internal Revenue Service is issuing temporary regulations amending previously issued temporary regulations on the limitations on passive activity losses and passive activity credits. The text of those temporary regulations also serves as the comment document for this notice of proposed rulemaking.

DATES: These regulations are proposed to be effective for taxable years beginning after December 31, 1986. Comments and requests for a public hearing must be delivered or mailed by May 29, 1990.

ADDRESS: Send comments and requests for a public hearing to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Room 4229, Washington, D.C. 20044 (Attn: CC:CORP:T:R (PS-065-89)).

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations in *** [T.D. 8290, page 109, this Bulletin] amend §1.469-2T(c)(7) and (d)(2) in Title 26 of the Code of Federal Regulations. Section 1.469-2T(c)(7) excludes certain gross income from passive activity gross income. Section 1.469-2T(d)(2) excludes certain deductions from passive activity deductions. This document proposes to adopt the temporary regulations as final regulations. Accordingly, the text of the temporary regulations serves as the comment document for this notice of proposed rulemaking. In addition, the preamble to the temporary regulations explains the proposed and temporary rules.

For the text of the temporary regulations, see T.D. 8290, published in *** [page 109, this Bulletin].

Special Analyses

It has been determined that these proposed rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) and the Regulatory Flexibility Act (5 U.S.C. Chapter 6) do not apply to these regulations, and therefore, an initial Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted, consideration will be given to any written comments that

are submitted (preferably a signed original and seven copies) to the Internal Revenue Service. All comments will be available for public inspection and copying. A public hearing will be scheduled and held upon written request by any person who submits written comments on the proposed rules. Notice of the time and place for the hearing will be published in the Federal Register.

List of subjects in 26 CFR 1.441-1—1.483-2

Accounting, Deferred compensation plans, Income taxes.

Fred T. Goldberg, Jr.,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on February 23, 1990, 8:45 a.m., and published in the issue of the Federal Register for February 28, 1990, 55 F.R. 7006)

Anrlouncement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
DiRicco, Dennis	San Mateo, CA	Attorney	Indefinite from November 16, 1989
Marcus, Murray A.	Valley Stream, NY	Certified Public Accountant	Indefinite from November 20, 1989
McNea, Ted G.	Shepherd, MT	Certified Public Accountant	Indefinite from November 2, 1989
Russell, Donnie B.	Palm Beach Gardens, FL	Certified Public Accountant	Indefinite from November 2, 1989
Wright, Carl E.	Joplin, MO	Certified Public Accountant	Indefinite from December 12, 1989
Brickle, Thomas C.	Washington, D.C.	Attorney	Indefinite from February 27, 1990
Hainsworth, David N.	Fairfax, VA	Certified Public Accountant	Indefinite from February 7, 1990
Harrison, Robert W.	Folkston, GA	Attorney	Indefinite from February 9, 1990
Joyner, George E., Jr.	Sumter, SC	Certified Public Accountant	Indefinite from February 7, 1990
Tierney, Thomas W.	Kansas City, MO	Attorney	Indefinite from February 7, 1990
Homsey, Walter, Jr.	Cedar Rapids, IA	Attorney	March 2, 1990 thru March 1, 1992

Under Section 330, Title 31 of the United States Code (1970 ed), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary and the date of disbarment or period of suspension.

This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
Alexander, Lee	Syracuse, NY	Attorney	December 31, 1989
Crooks, John	Tehachapi, CA	Attorney	December 16, 1989
Jerde, Larry A.	Aberdeen, SD	CPA	February 28, 1990

After due notice and hearing before an administrative law judge, the following individual has been suspended from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Griffin, James H.	Los Angeles, CA	Attorney	Indefinite from November 28, 1989

The abbreviation and number in parentheses following the index entry refer to the specific item; numbers following the parentheses refer to the page number on which it appears.

Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
PTE	Prohibited Transaction Exemption

EMPLOYMENT TAX

Deficiencies:
- Adjusted interest rate (RR 19) 186; (RR 47) 187

Federal services;
- Reemployed federal annuitant, adjusted salary (RR 32) 177

Omnibus Budget Reconciliation Act of 1989:
- Revenue Reconciliation Act of 1989, revenue measures, medicare as secondary payer (PL 101-239) 210

Overpayments:
- Adjusted interest rate (RR 19) 186; (RR 47) 187

Proposed regulations:
- 26 CFR 31.3121(a)-1(h), 31.3231(e)-1(a)(3)(iv), 31.3306(b)-1(h), 31.3401(a)-1(b)(2), amended; 31.3121(a)-2T, 31.3231(e)-3T, 31.3306(b)-2T, 31.3401(a)-2T, added; employee business expenses, reporting and withholding on employee business expense reimbursements and allowances (EE-8-89) 616

Railroad retirement:
- Rate determination, quarterly (beginning January 1, 1990) 178; (beginning April 1, 1990) 178

EMPLOYMENT TAXES—Continued

Regulations:
- 26 CFR 31.3121(a)-1(h), 31.3231(e)-1(a)(3)(iv), 31.3306(b)-1(h), 31.3401(a)-1(b)(2), amended; 31.3121(a)-2T, 31.3231(e)-3T, 31.3306(b)-2T, 31.3401(a)-2T, added; employee business expenses, reporting and withholding on employee business expense reimbursements and allowances (TD 8276) 14

Returns:
- Change of address (RP 18) 491

Rulings:
- Areas in which advance rulings will not be issued:
  - Associate Chief Counsel (Technical) (RP 3) 402; (RP 3A) 409
- Determination letters, closing agreements, Associate Chief Counsel (Technical) (RP 1) 356
- Technical advice to District Directors and Chiefs, Appeals Offices, Associate Chief Counsel (Technical), issuance procedures (RP 2) 386
- User fees (RP 17) 479

Self-employment tax:
- Social Security contribution and benefit base 556

ESTATE & GIFT TAXES ADMINISTRATIVE

Deficiencies:
- Adjusted interest rate (RR 19) 186; (RR 47) 187

Omnibus Budget Reconciliation Act of 1989:
- Revenue Reconciliation Act of 1989, revenue measures, medicare as secondary payer (PL 101-239) 210

Overpayments:
- Adjusted interest rate (RR 19) 186; (RR 47) 187

Returns:
- Change of address (RP 18) 491

Rulings:
- Areas in which advance rulings will not be issued:
  - Associate Chief Counsel (Technical) (RP 3) 402; (RP 3A) 409
  - Charitable remainder trusts (RP 33) 551
- Determination letters, closing agreements, Associate Chief Counsel (Technical) (RP 1) 356

ESTATE & GIFT TAXES ADMINISTRATION—Continued

Rulings—Continued
- Technical advice to District Directors and Chiefs, Appeals Offices, Associate Chief Counsel (Technical), issuance procedures (RP 2) 386
- User fees (RP 17) 479

ESTATE TAX

Administrative expenses:
- Deductibility of sales expenses and late-payment interest on additional estate tax (RR 8) 173

Charitable, etc., transfers:
- Trust remainder:
  - Sample forms (RP 30) 534; (RP 31) 539; (RP 32) 546

Interests in property:
- Disclaimer by surviving spouse of elective share (RR 45) 175

Marital deduction:
- Residuary bequest to spouse, pecuniary bequest payable at fair market value (RR 3) 174
- Second limitation on credit for tax on prior transfers (RR 2) 169

Transfers:
- Life insurance, within 3 years of death (RR 21) 172

Valuation:
- Farms and closely held businesses:
  - Special use value, interest rates (RR 49) 171

GIFT TAX

Charitable, etc., transfers:
- Trust remainder:
  - Sample forms (RP 30) 534; (RP 31) 539; (RP 32) 546

EXCISE TAXES

Chemicals:
- Deplete ozone layer:
  - Erroneous refunds (Notice 42) 356
  - Filing return, paying tax (Notice 35) 342
  - Imported products containing such chemicals (Notice 8) 305
- Imported products table, ozone-depleting chemicals tax (Notice 9) 312

Deficiencies:
- Adjusted interest rate (RR 19) 186; (RR 47) 187

EXCISE TAXES—Continued

Foreign insurance policies:
Treaty-based return positions (Notice 40) 350
Omnibus Budget Reconciliation Act of 1989:
Revenue Reconciliation Act of 1989, revenue measures, medicare as secondary payer (PL 101-239) 210
Overpayments:
Adjusted interest rate (RR 19) 186; (RR 47) 187
Returns:
Change of address (RP 18) 491
Rulings:
Areas in which advance rulings will not be issued:
Associate Chief Counsel (Technical) (RP 3) 402; (RP 3A) 409
Determination letters, closing agreements, Associate Chief Counsel (Technical) (RP 1) 356
Technical advice to District Directors and Chiefs, Appeals Offices, Associate Chief Counsel (Technical), issuance procedures (RP 2) 386
User fees (RP 17) 479
Transportation:
Persons:
New tax by water (Notice 10) 319

INCOME TAX

Accounting methods:
Ceding commissions, life insurance companies (Notice 3) 303
Administration:
Delegation of authority:
Change position titles (DO 4 (Rev. 20)) 294
Pen registers and to monitor communications (DO 222 (Rev. 2)) 296
Re-delegation of 31 CFR 103 (Bank Secrecy Act Regulations) (DO 143 (Rev. 4)) 295
Banks:
Interest expense of financial institutions (RR 44) 54
Property transfer by insolvent taxpayer (RR 16) 12
Bonds:
Mortgage revenue, mortgage credit certificates, national average purchase prices, average area purchase price safe harbor limitations (RP 24) 510

INCOME TAX—Continued

Bonds—Continued
Qualified mortgage bonds, mortgage credit certificates, national median gross income (RP 25) 511
State or local arbitrage rebate, innocent failure (RP 11) 469
U.S. savings bonds, exclusions of interest, higher education expenses (Notice 7) 304
Business expenses:
Automobile owners and lessees (RP 22) 504
Meal expenses of self-employed individuals and employees (RP 15) 476
Reimbursements, amounts on W-2 (Notice 14) 322
Rev. Rul. 190 distinguished, transportation expenses (RR 23) 28
Substantiation of employee business expenses incurred in driving an automobile for business purposes (RP 34) 552
Carrying charges:
Capitalized, binding election, subsequent deductions (RR 38) 57
Charitable contributions:
Deductible amount, patrons receiving something in return (RP 12) 471
Closing agreements
Recognition of gain, certain section 332 liquidations (RP 19) 495
Consolidated returns:
Extension, qualified restructuring (Notice 5) 303
Contracts:
Binding, interpretation, 1989 Act (Notice 6) 304
Controlled foreign corporations:
Earnings and profits, effect on section 1248, dividends (RR 31) 147
Cooperatives:
Deductions, nonresidential units (RR 35) 48
Deductions allowed tenant-stockholders (RR 36) 59
Corporations:
Segregation of options under section 1.382-2T (RR 15) 93
Credits against tax:
Nonconventional source fuel, inflation adjustment factor and reference price, 1989 (Notice 29) 340
Deficiencies:
Adjusted interest rate (RR 19) 186; (RR 47) 187

INCOME TAX—Continued

Depreciation:
Alternative system:
Cargo containers (RR 9) 46
Election for cargo containers (RP 10) 467
Dividends:
Received:
Dutch-auction rate preferred stock, deduction (RR 27) 50
Elections:
Late elections out of the installment method (RR 46) 107
Employee plans:
Administrative:
Issuance of determination letters, certain defined contribution plans (RP 20) 495
Modification of Rev. Procs. 89-9 & 89-13 (RP 21) 499
Sec. 6039D reporting requirements (Notice 24) 335
Contributions and benefits:
Cost-of-living adjustment, dollar limitations (Notice 17) 327
Direct transfers, 403(b) investment vehicles (RR 24) 97
Repeal of section 89 (PL 101-140) 207
Funding:
Current liability of a qualified plan, reasonable interest rate (Notice 11) 319
Full funding limitations, current liability for December 1989 (Notice 4) 303; January 1990 (Notice 12) 321; February 1990 (Notice 22) 334; March 1990 (Notice 32) 341; April 1990 (Notice 36) 342; May 1990 (Notice 39) 349
Individual retirement programs:
Form 990-T filing for IRA multiple trusts (Notice 18) 327
Medicare Catastrophic Coverage:
Maintenance of effort provision, refunds paid or benefits received (Notice 2) 301
Qualification:
Dependent care assistance program (PL 101-140) 207
Instructions for computer generated Forms 5300 and 5307 (Notice 38) 345
Estates and trusts:
Common trust fund, change to calendar year, short taxable year (Notice 1) 297
Exchange of investment trust certificates for trust assets, gain or loss recognition (RR 7) 153

Exempt organizations:
Qualification:
Cooperative associations, stock ownership (RP 29) 533; (RR 42) 117
Unrelated income:
Partnerships (Notice 41) 350
Exploration and development:
Carrying party's costs, mineral property, deductibility (RR 20) 117
Extension of time:
Extension of the March 10, 1990, reporting deadline in temp. reg. 301.6114-1T(e) (Notice 19) 328
Foreign corporations:
Argentina, FIRPTA, shipping agreement (RR 37) 141
Taxable year (RP 26) 512
Foreign insurance companies:
Domestic asset/liability percentages and domestic investment yields, estimated tax payments (Notice 13) 321
Foreign tax credit:
Domestic corporation owns 10 percent or more of voting stock of foreign corporation (CD 2047) 142
International boycotts, countries requiring cooperation (Notice 16) 326; (Notice 33) 341
Loss reserve reporting requirement, safe harbors (RR 14) 112
Rules relating to the adjustment to the pools of foreign taxes and earnings and profits (Notice 26) 336
Forms:
Magnetic Media Forms 8596 & 8596-A, information returns, federal contracts (RP 28) 518
Magnetic tape, Form W-4, reporting requirements (RP 9) 460
Substitute, computer-prepared, computer-generated (RP 8) 434
Government depositary:
Acceleration of tax deposits, interim guidance (Notice 37) 343
Gross income:
Exclusions-inclusions:
Crop insurance proceeds, section 451(d) (Notice 28) 33[illegible]
Corporation, adoption of poison pill plans (RR 11) 10
Fringe benefits, SIFL, aircraft valuation formula (RR 4) 13; (RR 43) 13
Leave-sharing plan, paid by employer (RR 29) 11

Gross income—Continued
Exclusions-inclusions—Continued
Property transfer by insolvent taxpayer to a bank (RR 16) 12
Industrial development bonds:
Private activity bonds, issuance costs (RR 51) 22
Installment sales:
Treatment under sections 382, 384, and 1374 (Notice 27) 336
Insurance companies:
Life:
Ceding commissions (Notice 3) 303
Loss reserves, discounting unpaid losses (RR 26) 124
Other than life or mutual:
Discounted unpaid losses, discount factors, fire and casualty companies (RP 23) 507
Interest:
Investment:
Federal short-term, mid-term, and long-term rates (RR 1) 155; (RR 12) 156; (RR 22) 158; (RR 28) 159; (RR 41) 161; (RR 48) 162
Inventories:
Capitalization of interest (RR 40) 52
LIFO:
Price indexes, department stores (RR 6) 111; (RR 14) 112; (RR 30) 113; (RR 33) 114; (RR 39) 115; (RR 50) 116
Investment credit:
Recapture, property transferred to trustee in bankruptcy (RR 25) 10
Losses:
Casualty, disaster areas, year of deduction (RR 10) 42
Casualty and theft losses, passive activity (Notice 21) 332
Omnibus Budget Reconciliation Act of 1989:
Revenue Reconciliation Act of 1989, revenue measures, medicare as secondary payer (PL 101-239) 210
Overpayments:
Adjusted interest rate (RR 19) 186; (RR 47) 187
Partnerships:
Continuation of partnership (RR 17) 119
Limited, State of Mississippi (RR 18) 193
Penalties:
Return preparer penalty, substantial authority (Notice 20) 328

Penalties—Continued
Substantial understatement (RP 16) 477
Proposed regulations:
26 CFR 1.56(g)-0, 1.56(g)-1, added; 1.926(a)-1T(b)(1) revised; alternative minimum tax for corporations (IA-29-89) 663
26 CFR 1.62-1T, 1.162-25T(b), 1.274-5T(g), amended; 1.62-2T, 1.162-17(e)(3), added; 1.6041-3(i), revised employee business expenses, reporting and withholding on employee business expense reimbursements and allowances (EE-8-89) 616
26 CFR 1.148-10T, added; yield adjustment payments for qualified student loan bonds (FI-75-89) 631
26 CFR 1.163-11T, 1.125-6T, 1.6050H-2T, added; price level adjusted mortgages (PLAMs) (FI-64-89) 631
26 CFR 1.280F-7T, amended; leased passenger automobiles, limitations on tax deductions (TD 8298) 64
26 CFR 1.337(d)-1T, 1.1502-1T, 1.1502-20T, added; 1.1502-12, 1.1502-32, 1.1502-33(c)(6), 1.1502-79, amended; consolidated returns, dispositions and deconsolidations of subsidiary stock (CO-78-87) 558
26 CFR 1.367(a)-1T, 7.367(b)-1, amended; 1.367(e)-0T, 1.367(e)-1T, 1.367(e)-2T, added; 1.381(b)-1(a)(1), revised; corporate distributions to foreign corporations (INTL-704-87) 678
26 CFR 1.382-2T, amended; limitations on corporate net operating loss carryforwards (CO-10-89) 559
26 CFR 1.401(a)-4, 1.401(a)(5)-1, 1.410(b)-5, 1.410(b)-10, 1.411(d)-4, amended; 1.401(a)(4)-0 through 1.401(a)(4)-13, added; nondiscrimination requirements for qualified plans (EE-61-88) 573
26 CFR 1.401(a)(17)-1, added; 1.401(k)-1, 1.401(l)-1, 1.401(l)-3, 1.401(l)-4, 1.401(m)-1, 1.401(m)-2, 1.410(b)-2, 1.410(b)-6, amended; 1.410(b)-9(g), revised; miscellaneous regulations for qualified plans (EE-22-90) 617

Proposed regulations—Continued

26 CFR 1.401(a)(26)-0 through 1.401(a)(26)-8, added; minimum participation requirements (EE-44-87) 561

26 CFR 1.414(s)-1T, 1.415-2, revised; definition of compensation (EE-129-86) 560

26 CFR 1.451-6T, added; taxable year of inclusion for crop insurance proceeds (IA-012-90) 678

26 CFR 1.469-2T, amended, limitations on passive activity losses and credits (PS-065-89) 681

26 CFR 1.832-4T, 1.832-7T, amended; treatment of salvage and reinsurance (FI-76-89) 632

26 CFR 1.852-11T, added; treatment of certain losses attributable to periods after Oct. 31 of a taxable year of a regulated investment company (FI-105-88) 630

26 CFR 1.964-1T, added; earnings and profits of controlled foreign corporations (INTL-40-89) 679

26 CFR 1.1031(a)-1, amended; 1.1031(a)-3, added; like-kind exchanges (IA-237-84) 633

26 CFR 1.1031(a)-1(b), 1.1031(b)-1(c), amended; 1.1031(a)-2, 1.1031(f)-1, added; like-kind exchanges of personal property and multiple properties (IA-12-89) 654

26 CFR 1.1441-4, amended; 1.1441-4T, added; withholding of tax on nonresident aliens (INTL-0660-89) 680

26 CFR 1.1502-13, 1.1502-13T, 1.1502-14, 1.1502-14T, amended; consolidated returns, intercompany transactions and distributions of property (CO-008-90) 559

26 CFR 1.6045-3T, amended; 1.6045-4, added; information reporting on real estate transactions (IA-130-87) 645

26 CFR 301.7605-1(a), removed; 301.7605-1T, added; time and place of examination (GL-705-88) 632

Rates of tax:

Income tax cost-of-living adjustments (RP 7) 432

Social Security contribution and benefit base 556

INCOME TAX—Continued

Redemption of stock and bonds:

Partial liquidation, pro rata distribution and shareholder surrender of stock (RR 13) 65

Regulations:

26 CFR 1.40-1, revised; alcohol fuels credit (TD 8291) 3

26 CFR 1.42-0, 1.42-2, added; 1.42-1, 1.42-2T, removed; low-income housing credit for Federally-assisted buildings (TD 8302) 6

26 CFR 1.62-1T, 1.162-25T(b), 1.274-5T(g), amended; 1.62-2T, 1.162-17(e)(3), added; 1.6041-3(i), revised; employee business expenses, reporting and withholding on employee business expense reimbursements and allowances (TD 8276) 14

26 CFR 1.67-3T, correction to T.D. 8259, real estate mortgage investment conduit (REMIC) (Notice 30) 340

26 CFR 1.148-10, added; arbitrage restrictions on qualified student loan bonds (TD 8284) 24

26 CFR 1.148-10, added; correction of errors in TD 8284, arbitrage restrictions on qualified student loan bonds (Notice 23) 335

26 CFR 1.148-10T, added; yield adjustment payments for qualified student loan bonds (TD 8285) 26

26 CFR 1.163-5(c), 35a.9999-5, 46.4701-1, amended; 1.163-5T(e), added; registration required obligations, repeal of 30% withholding on certain types of interest by the Tax Reform Act of 1984 (TD 8300) 31

26 CFR 1.163-11T, 1.1275-6T, 1.6050H-2T, added; price level adjusted mortgages (PLAMs) (TD 8281) 37

26 CFR 1.280C-4, added; election of reduced research credit (TD 8282) 62

26 CFR 1.280F-7T, amended; leased passenger automobiles, limitations on tax deductions (TD 8298) 64

26 CFR 1.337(d)-1T, 1.1502-1T, 1.1502-20T, added; 1.1502-12, 1.1502-32, 1.1502-33(c)(6), 1.1502-79, amended; consolidated returns, dispositions and deconsolidations of subsidiary stock (TD 8294) 66

INCOME TAX—Continued

Regulations—Continued

26 CFR 1.367(a)-1T, 7.367(b)-1, amended; 1.367(e)-0T, 1.367(e)-1T, 1.367(e)-2T, added; 1.381(b)-1(a)(1), revised; corporate distributions to foreign corporations (TD 8280) 80

26 CFR 1.382-2T, amended; limitations on corporate net operating loss carryforwards (TD 8277) 96

26 CFR 1.414(s)-1T, 1.415-2, revised; definition of compensation (TD 8301) 99

26 CFR 1.451-6T, added; taxable year of inclusion for crop insurance proceeds (TD 8289) 106

26 CFR 1.469-2T, amended; limitations on passive activity losses and credits (TD 8290) 109

26 CFR 1.807-1T, 1.807-2, removed; 1.807-1, revised; mortality and morbidity tables (TD 8278) 121

26 CFR 1.832-4T, 1.832-7T, amended; treatment of salvage and reinsurance (TD 8293) 123

26 CFR 1.852-11T, added; treatment of certain losses attributable to periods after Oct. 31 of a taxable year of a regulated investment company (TD 8287) 130

26 CFR 1.861-8, amended; apportionment of expenses in the FSC and DISC contexts (TD 8286) 138

26 CFR 1.964-1T, added; earnings and profits of controlled foreign corporations (TD 8283) 148

26 CFR 1.964-1T, added; corrections to T.D. 8283 (Notice 25) 336

26 CFR 1.989(a)-0T, 1.989(a)-1T, removed; 1.989(a)-1, added; definition of a qualified business unit (TD 8279) 151

26 CFR 1.1441-4, amended; 1.1441-4T, added; withholding of tax on nonresident aliens (TD 8288) 163

26 CFR 1.1502-13, 1.1502-13T, 1.1502-14, 1.1502-14T, amended; consolidated returns, intercompany transactions and distributions of property (TD 8295) 165

26 CFR 1.1503-2T, correction to T.D. 8261, dual consolidated losses (Notice 31) 341

Regulations—Continued
26 CFR 1.6050M-1, added; corrections to T.D. 8275, returns relating to persons receiving contracts from Federal executive agencies (Notice 34) 341
26 CFR 301.6103(j)(1)-1, revised; disclosure of return information to Bureau of the Census (TD 8296) 179
26 CFR 301.6114-1T, 301.6712-1T, removed; 301.6114-1, 301.6712-1, added; treaty-based return positions (TD 8292) 180
26 CFR 301.6404-0T & 301.6404-3T, redesignated; abatement of penalty or addition to tax attributable to erroneous advice (TD 8299) 185
26 CFR 301.7605-1(a), removed; 301.7605-1T, added; time and place of examination (TD 8297) 190
Reorganizations:
Financial institutions, federal financial assistance provided (PL 101-73) 204
Returns:
Change of address (RP 18) 491

Returns—Continued
Legal holiday filing requirements (RR 5) 189
Magnetic Media Forms 8596 & 8596-A, information returns, federal contracts (RP 28) 518
Magnetic media reporting, information returns (Notice 15) 326
Rulings:
Areas in which advance rulings will not be issued:
Associate Chief Counsel (International) (RP 6) 430
Associate Chief Counsel (Technical) (RP 3) 402; (RP 3A) 409
Areas in which rulings or determination letters will not ordinarily be issued, private activity bonds (RP 35) 555
Determination letters, closing agreements, Associate Chief Counsel (Technical) (RP 1) 356; (RP 13) 473
Exempt organizations, private foundations, procedures (RP 27) 514

Rulings—Continued
Rulings and determination letters, issuance procedures (Employee Plans and Exempt Organizations) (RP 4) 410
Technical advice, Key District Director & Chiefs (Employee plans and Exempt Organizations) (RP 5) 421
Technical advice to District Directors and Chiefs, Appeals Offices, Associate Chief Counsel (Technical), issuance procedures (RP 2) 386
User fees (RP 17) 479
Sales or exchanges:
Conflict-of-interest requirement, Ethics Reform Act of 1989 (PL 101-194) 209
Direct transfers of like-kind property (RR 34) 154
Self-employment tax:
Social Security contribution and benefit base 556
Tax conventions:
Mexico, exchange of information (TC) 196
Puerto Rico, exchange of information and mutual assistance (TC) 199

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